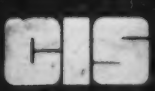
NOTE

This Microfiche meets the quality requirements of the American National Standard for Microfiche of Documents (ANSI PH5.9-1975). However, because of imperfections in the document from which it was made, it contains images that are illegible or difficult to read. The source document for this microfiche is the best copy that could be obtained prior to filming.



Congressional Information Service
Washington, D.C.

S. HRG. 101-593

ESOPs AND RETIREE HEALTH

HEARING

BEFORE THE

SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

AND THE

SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS
AND OVERSIGHT OF THE INTERNAL REVENUE
SERVICE

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

S. 812, S. 1171, and S. 1303

JULY 19, 1989

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

28-281 ⇆ WASHINGTON : 1990

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S361-24

COMMITTEE ON FINANCE

LLOYD BENTSEN, Texas, *Chairman*

SPARK M. MATSUNAGA, Hawaii	BOB PACKWOOD, Oregon
DANIEL PATRICK MOYNIHAN, New York	BOB DOLE, Kansas
MAX BAUCUS, Montana	WILLIAM V. ROTH, JR., Delaware
DAVID L. BOREN, Oklahoma	JOHN C. DANFORTH, Missouri
BILL BRADLEY, New Jersey	JOHN H. CHAFEE, Rhode Island
GEORGE J. MITCHELL, Maine	JOHN HEINZ, Pennsylvania
DAVID PRYOR, Arkansas	DAVE DURENBERGER, Minnesota
DONALD W. RIEGLE, JR., Michigan	WILLIAM L. ARMSTRONG, Colorado
JOHN D. ROCKEFELLER IV, West Virginia	STEVE SYMMS, Idaho
TOM DASCHLE, South Dakota	

VANDA B. MCMURTRY, *Staff Director and Chief Counsel*
EDMUND J. MIHALSKI, *Minority Chief of Staff*

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

SPARK M. MATSUNAGA, Hawaii, *Chairman*

LLOYD BENTSEN, Texas	WILLIAM V. ROTH, JR., Delaware
MAX BAUCUS, Montana	JOHN C. DANFORTH, Missouri
DAVID L. BOREN, Oklahoma	STEVE SYMMS, Idaho
DAVID PRYOR, Arkansas	

SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS AND OVERSIGHT OF THE INTERNAL REVENUE SERVICE

DAVID PRYOR, Arkansas, *Chairman*

DANIEL PATRICK MOYNIHAN, New York	JOHN HEINZ, Pennsylvania

CONTENTS

OPENING STATEMENT

Page

Baucus, Hon. Max, a U.S. Senator from Montana 1

COMMITTEE PRESS RELEASE

Finance Subcommittee To Hold Joint Hearing on ESOPs and Retiree Health .. 1

ADMINISTRATION WITNESS

Trier, Dana, Acting Deputy Assistant Secretary for Tax Policy, U.S. Department of the Treasury 2

CONGRESSIONAL WITNESSES

Dixon, Hon. Alan J., a U.S. Senator from Illinois 7
Metzenbaum, Hon. Howard M., a U.S. Senator from Ohio 8

PUBLIC WITNESSES

Long, Hon. Russell B. (former U.S. Senator), Long Law Firm, Washington, DC, accompanied by Jeff Gates, Kelson Law Firm, Washington, DC 13
Koch, Steven R., vice president/treasurer, the Peoria Journal Star, Inc., testifying on behalf of the ESOP Association, Peoria, IL 17
Huard, Paul R., vice president, department of taxation and fiscal policy, National Association of Manufacturers, Washington, DC 18
Stair, John E., Jr., manager, employee compensation and benefits division, DuPont Co., testifying on behalf of the Coalition for Retirement Income Security (CRIS), Wilmington, DE 29
Schanes, Steven, worker equity volunteer, American Association of Retired Persons, San Diego, CA, accompanied by David Certner, legislative representative 31

APPENDIX

Alphabetical Listing and Material Submitted

Baucus, Hon. Max:
  Opening statement 1
  Joint Committee on Taxation Reports on:
    Employee Stock Ownership Plans (Including S. 1303 and S. 1171) 41
    Employer-Provided Retiree Health Insurance 44
Chandler, Hon. Rod:
  Prepared statement 58
Dixon, Hon. Alan J.:
  Testimony 7
Huard, Paul R.:
  Testimony 18
  Prepared statement 61
Koch, Steven R.:
  Testimony 17
  Prepared statement 65
Long, Hon. Russell B.:
  Testimony 13
  Prepared statement 67

Page

Metzenbaum, Hon. Howard M.:
Testimony 8
Prepared statement 70
Schanes, Steven:
Testimony 31
Prepared statement 71
Stair, John E., Jr.:
Testimony 29
Prepared statement with attachments 75
Trier, Dana:
Testimony 2
Prepared statement 84

COMMUNICATIONS

AFL–CIO 91
Allied-Signal, Inc. 93
BellSouth Corp. 96
Boise Cascade Corp. 101
Branham 102
Canterbury Press 103
Conrail 104
Chubb Corp. 105
Follett Corp. 106
Kelso & Co. 106
Lukens, Inc. 113
MassMutual 114
Morgan Stanley 115
Pension Rights Center 117
Senate Finance Committee: Responses to Committee Press Release 118
Southwestern Bell Corp 159
Turner Corp. 161
UAW 161
Upjohn Co. 169
U.S. Chamber of Commerce 170

ESOPs AND RETIREE HEALTH

WEDNESDAY, JULY 19, 1989

U.S. SENATE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
AND THE SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS
AND OVERSIGHT OF THE INTERNAL REVENUE SERVICE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 3:13 p.m., in room SD-215, Dirksen Senate Office Building, Hon. Max Baucus presiding.

Also present: Senators Pryor, Rockefeller, Packwood, and Durenberger.

[The press release announcing the hearing follows:]

[Press Release No. H-44, July 14, 1989]

FINANCE SUBCOMMITTEES TO HOLD JOINT HEARING ON ESOPs AND RETIREE HEALTH

WASHINGTON, DC—Senator Spark M. Matsunaga (D., Hawaii), chairman, Subcommittee on Taxation and Debt Management, and Senator David Pryor, (D., Arkansas), chairman, Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service, announced Friday that the two Subcommittees will hold a joint hearing on Employee Stock Ownership Plans (ESOPs) and retiree health proposals.

The hearing is scheduled for *Wednesday, July 19, 1989 at approximately 3:15 p.m.* in Room SD-215 of the Dirksen Senate Office Building. This hearing will begin immediately following the previously scheduled Subcommittee on Taxation and Debt Management hearing on a bill to increase the public debt limit.

The joint hearing will focus on current proposals relating to ESOPs, including S. 1303, introduced by Senator Bentsen; S. 1171, introduced by Senator Dole; and various proposals under consideration by the House Ways & Means Committee. Additionally, the Subcommittees will review several proposals on retiree health, including S. 812, introduced by Senator Pryor, and other proposals under consideration by the House Ways & Means Committee.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. Our first witnesses are Hon. Senator Metzenbaum and Hon. Rod Chandler from the State of Washington. I do not see either of them. Next, Mr. Dana Trier, Acting Deputy Assistant Secretary for Tax Policy.

Mr. Trier.

Mr. TRIER. Do you want me to go ahead?

Senator BAUCUS. Why don't you go ahead.

Mr. TRIER. Okay.

STATEMENT OF DANA TRIER, ACTING DEPUTY ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. TRIER. We are testifying on both the retiree health and the ESOP provisions.

Senator BAUCUS. Fine.

Mr. TRIER. Thank you very much, Mr. Chairman. I am pleased to be here to present the Treasury Department's and the Administration's views on a variety of retiree health care proposals and proposals regarding ESOPs.

What I will do is divide my testimony into two parts. In the first part I will cover the various retiree health care proposals and in the second I will discuss the ESOP proposals and then I will take whatever questions you may have afterward.

With respect to the retiree health care proposals, there is really two types of things that are in the bills that we were asked to discuss. The first, which is in the proposed Pryor bill, and which has its counterpart in the Chandler proposed legislation, is a more general type of provision which would simply give additional tax benefits for so-called 401(h) accounts for retiree health care benefits and, in addition, for long-term care benefits.

This has been the subject of extensive testimony by us over on the House side. I would like to summarize briefly what our position is at this moment. As far as the Administration is concerned now, we are in opposition to any further general incentives for retiree health care—tax incentives for retiree health care. To summarize fairly briefly why that is, it is basically that we think it is premature, that there has not been a full enough discussion of exactly what is entailed with such benefits at this point.

I might make a few points that underscore our uneasiness. We had planned to issue a report on the tax aspects of health care sometime in the next several months and have been discussing all these issues in much more depth back at the Treasury Department. But the first thing we think you really have to think through if we move to a broader set of incentives is exactly whether or not tax incentives for employer-provided health care benefits, as opposed to health care benefits, generally, that may or may not be funded on the individual level is a wise move.

As we have seen as we address Section 89 and other topics that are current today, the system of employer-provided benefits with tax incentives is fraught with a lot of problems. We think many of those problems very well may be present with respect to the Chandler and Pryor type of legislation.

Secondly, we made note that there are a variety of technical issues that we do not think are thought out completely. The primarily important ones regard exactly what protection is given to the employees with respect to the benefits that are funded on their behalf by the employer. As you know, there is a whole panoply of such protections with respect to pension benefits. There is not so much with respect to health care benefits. And before we have broader legislation, we think that has to be fully discussed.

Third, with respect to the Pryor legislation which we were asked to comment on specifically, we might add that it does have new in-

centives for funding long-term care as well as retiree health and we think that that is something that has to be considered much more carefully before we embark on that road. If nothing else, simply the distinction between what is long-term care and the general personal expenses of older people in our country is a distinction that we do not see readily. We think we have to think very carefully before we go ahead and do that.

The proposals that are perhaps of more immediate interest—not to take anything away from this long-term problem of retiree health care—are the various proposals that have been made around concerning the use of surplus assets that are in pension plans. As you know, particularly the pension plans of large corporations today frequently have large surpluses. Anyway, we have a variety of proposals around which would permit a part of that surplus to be transferred in one way or another, either to a separate account or to a separate trust, for the purpose of relieving and funding the retiree health costs of the employer so that you take this surplus and move it over there.

Generally speaking, if you terminated the plan, took the excess and spent it for the employer's benefit, you would have both an income tax cost and an excise tax cost. But that would be relieved under all the proposals that we are talking about.

There are really three proposals, but I tend to think in my own terms and my own mind in terms of the so-called CRIS proposal, which as you know was put forward by a coalition of large corporations. The CRIS proposal would under certain conditions allow employers, subject to a 25 percent cushion, to take these surpluses to fund a trust that would be designed to pay the then-existing projected retiree health benefits.

The Pryor legislation contains a fairly similar proposal. In a much limited way, over in the House, Ways and Means side—on the House side in the House, Ways and Means Committee proposal which was tentatively adopted by the Committee last week—there would be a similar ability to transfer excess assets to pay liabilities that are paid or incurred simply in the years 1990 and 1991, not all the projected benefits.

This is the type of proposal that we have been considering at the Treasury Department or are discussing the merits of over the last 3 or 4 weeks. Today I would like to give you a little bit of my perspective on it.

First of all, the very first initial question for us is exactly what the revenue effect is of these proposals. In our testimony 3 weeks ago on the House side we indicated that we were not finished with our own estimates of what those proposals would raise. As you know, one of the selling points of these proposals is since the deduction would be disallowed for the retiree health payments—the otherwise allowable deductions would be disallowed—even though the employer would not take into income the surplus, that you would, in fact, raise money.

Our current figures are somewhat different than the Joint Committee figures are, as we understand them. But they are not ridiculously different. For the CRIS proposal, the Joint Committee has that as raising $3.2 billion over the budget period, with $500 million in 1990. With respect to the Ways and Means Committee pro-

posal, which is necessarily a smaller proposal, they have that raising $930 million over the budget period with $286 million in 1990. We have it raising $665 million with $172 million in 1990.

We believe that assuming that our preliminary estimates prove to be true, and presuming that the out years that has passed the budgetary period are proven not to be a bath, and under neither proposal does that appear to be true, although there is a turn around in the CRIS proposal by our estimate in 1997, that these types of proposals do merit serious consideration.

The Treasury Department—the whole Administration has not signed off on this, but the Treasury Department—is not in opposition to trying to work something out. Now the question is, precisely what is the design to be? I will give you a few of my comments there.

First, if nothing else, out of a spirit of what I would call conservatism, our own preference is to use the more limited Ways and Means proposal as sort of the foundation for our work in trying to take care of all the holes. It is a much smaller proposal. There is an uncertainty on the part of all of us as to exactly how this is going to work out, both from a revenue point of view and a practical point of view. We think that prudence would dictate that we concentrate our efforts on it.

A second sort of design question relates to the level of security, or the level of protection, that is afforded, or is required, with respect to the participants and the plan from the which the excess assets are transferred. There is some variation among the proposals in this regard. Although, we generally do think that 25 percent excess assets has proven to be enough, which is what is allowed under CRIS and Pryor, we would be much more comfortable with the larger cushion that is provided under the House Ways and Means Committee proposal which is basically a 145 percent requirement.

The second design question is, precisely what are the requirements with respect to the money that is transferred over? What are the rules and regulations governing what is done with that? In all the proposals, there is a certain amount of vagueness in this regard.

I will say a couple points from the Administration's point of view. One is that by in large we would prefer that the money not be usable to fund early retirement benefits which we think are something that the tax system should not be encouraging for a variety of reasons.

Secondly, we, as I said earlier, would prefer that the money involved be used just to fund current benefits.

I will summarize my ESOP.

Senator BAUCUS. Could you be very brief because we have a vote. Could you summarize, say, in 2 minutes and then I will allow Senator Metzenbaum to give his testimony.

Mr. TRIER. Sure enough.

To summarize for 30 seconds where we are on the retired health. We do think the transfer proposals merit significant further discussion. Not all parts of the Administration have signed off of them. We think the detail work has to be done. But we think we should go forward with them.

On the ESOP proposals there is, I guess, three of them that we were asked to discuss. One is Senator Bentsen's proposal which would limit the Section 133 exclusion for half the interest on ESOP loans, except in the case where there is 30 percent ownership by the ESOP of the company and the voting rights are passed through, et cetera.

The Dole proposal, which would simply deny the interest exclusion going forward. And we were asked to briefly mention the House Ways and Means proposal which is a little bit more complicated.

I will say a few words about Section 404(k) which has been discussed on the House side, which is the dividends paid deduction. We strongly support ESOPS. We think Section 133 had laudatory purposes. In all candor though it has proven to be much more costly than we expected. It hasn't had exactly the impact that we expected. For that reason we do support either an effort to repeal it or to target it significantly as is evident under Senator Bentsen's proposal. Therefore, we are in favor of legislative action at the moment.

Five seconds on Section 404(k) which did come up. It's really not the subject of present legislation on the Senate side. We had a different attitude towards Section 404(k), which is the dividends pay deduction. The major reason for that different attitude is that we feel leery about taking away two major benefits of ESOPs at the same time, given our basic attitude towards ESOPs and the fact that we have seen increasing use of them.

However, we would not oppose efforts like those exemplified on the House side to target the dividends pay deduction better.

Thank you very much.

[The prepared statement of Mr. Trier appears in the appendix.]

Senator BAUCUS. In the interest of time, Senator, why don't you give your statement now.

Senator METZENBAUM. Senator, if it meets with your approval, because I feel very strongly about the subject and don't want to just rush through it, I would be very happy to return right after the vote if you are going to be meeting after the vote anyway.

Senator BAUCUS. As I understand it, we have a bigger problem here. I think there are three——

Senator PRYOR. I have told Senator Baucus that I think we have three back-to-back votes coming up. I am not certain. Am I wrong on that?

Senator BAUCUS. I heard we have two back-to-back.

Senator PRYOR. Well, maybe it is two.

Senator METZENBAUM. I am not sure.

Senator BAUCUS. Are you willing to wait, sir, that would be about 20 minutes?

Senator METZENBAUM. I have waited 6 years for this opportunity. [Laughter.]

Sure, I will be glad to come back.

Senator BAUCUS. Okay. Well, then let us—we will do that then. We will proceed with you immediately after the second vote.

Mr. Glauber, why don't you come back here then so we can ask you some questions? Mr. Trier, I am sorry.

Mr. TRIER. I got promoted again.

Senator BAUCUS. That is right.

So as I understand you, Secretary Trier, essentially you are saying that on Section 133 the Administration is not opposed to say a provision along the lines of a 30 percent ownership requirement. Is that correct?

Mr. TRIER. That is right.

Senator BAUCUS. And with respect to 404(k), the Administration believes that even with the 30-percent requirement as some suggest—I am thinking of the side that the Administration still is opposed to any changes in Section 404(k).

Mr. TRIER. I do not think it is fair to say we are opposed to any change. But we are much more leery. I mean, there may be technical targeting that we would support. But we were much more leery about a major cutback on Section 404(k). A lot of that is because we do not want to do two things at once, once we have seen the increase in the ESOP activity.

Senator BAUCUS. Thank you.

Senator Packwood.

Senator PACKWOOD. No questions.

Senator BAUCUS. Senator Pryor.

Senator PRYOR. I will make no answer. I will ask no questions at this time.

Senator BAUCUS. May I ask you, though, Mr. Trier, again, would the Administration oppose not the outright repeal of 404(k) but the limited change as provided by Ways and Means to 404(k)?

Mr. TRIER. I really cannot address that in isolation. We do not oppose the package that has come out of the House Ways and Means Committee under which 133 and 404(k) restrictions are tied together, and since we really do think the 133 restriction is appropriate. On an overall basis, we do that.

I think that we would certainly look carefully at the 30 percent rule or there is another restriction in there that the dividends pay deduction, for example, only be—and this is on the House side—that the dividends pay deduction only be available if it is either with respect to stock acquired with the proceeds of a loan or the dividends actually pass through the employees.

I think that kind of very specific targeting would probably be amenable for us.

Senator BAUCUS. What is the Administration's position on the Section 2057 repeal?

Mr. TRIER. Unfortunately, it is a similar answer to what I gave before. We have not addressed 2057 or the estate tax deduction, and the 414 cutback, et cetera, other than as part of the whole package that came out of the Anthony proposal and the Ways and Means proposal.

Taken together, in which you have allowed 133 in limited form to go forward, 404(k) to go forward, but we have taken some other ESOP benefits away, we do not oppose that proposal. Whether, if you ask me, Mr. Chairman, what do you think if we just woke up this morning and said we are going to take each of these things away, I think that we probably would oppose the taking away the estate tax deduction.

But it is really part of an overall package that allows 133 to go forward, albeit in limited form, with the cost of taking away the other ESOP proposals. We do not oppose it.

Senator BAUCUS. I have no further questions.

Senator Pryor.

Senator PRYOR. No questions, Mr. Chairman.

Senator BAUCUS. Thank you very much, Mr. Trier.

The Committee will recess for about 15 minutes.

[Whereupon, a recess was taken and the hearing resumed at 3:52 p.m.]

Senator BAUCUS. The Subcommittee will come back to order. I see Senator Metzenbaum has not returned. Let me now, therefore, turn to Senator Dixon, from Illinois, who wishes to introduce one of the witnesses on the subsequent panels.

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM ILLINOIS

Senator DIXON. Mr. Chairman, I greatly appreciate that. I am sure my friend, who will be a witness in a moment, Mr. Koch, understands that Senator Metzenbaum will be back soon and will yield to him then.

Mr. Chairman, it is a pleasure to present to this hearing in the presence of my dear friend, Senator Russell Long, of Louisiana, a representative of a very fine Illinois ESOP company, the Peoria Journal Star, of Peoria, IL. Mr. Steven R. Koch is the vice president and treasurer of the Peoria Journal Star.

Mr. Chairman, this company established an ESOP in 1983 in an effort to keep the newspaper independent and locally owned by people who have an interest and a stake in the community. And today, the employees of the Peoria Journal Star, Mr. Chairman, have acquired 82 percent ownership of the company and by the mid-1990's the Journal Star will be 100 percent entirely employee owned. I am quite pleased that you would ask an ESOP leader like Steve to testify.

As you know, Mr. Chairman, Steve appears before this Joint Hearing today representing not only the Peoria Journal Star, but also over 1,100 ESOP companies nationwide who are members of the Employee Stock Ownership Association. Steve is the Treasurer of the ESOP Association, and serves on the association's board and executive committee. The executive committee is the key group, outside of the outstanding activities of Senator Russell Long, that sets the policy of the private sector on ESOPs.

In addressing the Committee today, Steve Koch speaks for Illinois ESOP companies, as well as for ESOP companies in Montana, Arkansas, Hawaii, and across the Nation.

Mr. Chairman, I am a strong supporter of ESOPS and employee ownership. Within my State of Illinois, the Chicago Metropolitan area contains more ESOP companies than any other metropolitan area in the United States of America. I hope that the Committee ESOP recommendations will be ones that supporters of ESOPs can endorse. Having co-sponsored Senator Long's ESOP bills that created the ESOP tax incentives, having voted and spoken for them on the Senate floor, and having worked directly on the voting

rights issues in closely held companies, I pledge to work with the members of the Finance Committee in keeping our employer ownership program an ESOP program moving forward.

And, frankly, Mr. Chairman, I am concerned that our drive to raise revenues will threaten the survival of ESOPs and employee ownership. I am troubled that a 30 percent threshold may prevent our large publicly traded companies from establishing major ESOPs. And in addition, I am particularly disturbed by suggestions that the ESOP dividend deduction should be reduced. This benefit goes directly to employees. Furthermore, I believe we have to continue to respect the differences between publicly-traded and closely held companies on voting stock.

Again, Mr. Chairman, it is a great please and privilege for me to present Steve Koch to this Committee. I am sure that later you will find his views very enlightening. I do very much, Mr. Chairman, appreciate your accommodating Mr. Koch and this Senator in this regard.

Thank you.

Senator BAUCUS. Thank you very much, Senator.

At this point, let us have the entire panel come up—Senator Russell Long and Mr. Paul Huard. Mr. Koch, why don't you stay.

Senator BAUCUS. This Committee is very honored to have, as our first witness on this panel, Hon. Russell Long, who is greatly missed on this Committee. I must say I have not known any member of this Committee, present or former, who had a better sense and understanding of American tax law than Senator Long. Nor have I have known of a present or former member of this committee, who had a better understanding of human nature and what this country needs in tax or other legislation.

Senator, we are very honored to have you here.

In addition to Senator Long, we are honored to have Mr. Paul Huard, who is vice president, department of taxation and fiscal policy for the National Association of Manufacturers; as well as Mr. Koch, who was introduced by Senator Dixon.

I now see that Senator Metzenbaum is here. Senator, why don't you take a chair so that you can now give your statement.

Mr. Long. Mr. Chairman, since Senator Metzenbaum is going to be heard, I would suggest that we should hear from him now.

Senator BAUCUS. That would be fine.

Senator METZENBAUM. Thank you, Senator.

Senator BAUCUS. After 6 years, Senator, now is your chance.

STATEMENT OF HON. HOWARD M. METZENBAUM, A U.S. SENATOR FROM OHIO

Senator METZENBAUM. After 6 years I finally have my opportunity to be heard. This is a big occasion in my life. I want to thank you for the opportunity to testify this afternoon because you are dealing with a problem to which I have addressed myself for about 6 years and I have not made much progress. I have made the issue but I have not won the battle; and I sure have not won the war.

I am Chairman of the Subcommittee of Labor, which also has jurisdiction over pension and employee benefit plans. I am concerned that the Senate and the House may shortly move to rob the retired

workers of this country of cost-of-living adjustments. These are the men and women who have given of their lives to make X company, and Y company and Q company successful. They have given 25, and 30, and 35, and 40 years of their lives to these companies.

In hearings held before my Committee some of them were receiving $220, $240 a month while the corporation or somebody who had just made a leveraged buyout was reaching in and grabbing the pension monies and running.

The A&P Tea Co. was sold to some Germans. The Germans came in and terminated the pension fund and took more money out of that pension fund than the Germans had paid for the entire A&P Tea Company. LBO after LBO has terminated pension funds. The people who made the company that which it is have been left by the wayside.

In 1974 Congress passed the Employee Retirement Income Security Act, known as ERISA, in response to several large pension plan terminations that left tens of thousands of workers without retirement benefits. ERISA established comprehensive standards for pension plans. Employers generally were required to prefund pension plans over a 30 year period to ensure that the money needed to pay for benefits in the future would be there. All that sounds good.

ERISA has generally worked well. But in some ways, it has done too good a job. After 15 years of good funding and the strong investment returns these funds have earned, the majority of pension plans today are very well funded. It was not that anybody did anything special. It was that interest rates zoomed and the stock market went higher than anybody had ever anticipated and so there was an overfunding of the pension plans.

Pension plans currently contain approximately $250 billion in assets for retirement liabilities that are not yet due. Unfortunately, this pool of assets has created a great temptation for employers to terminate their pension plans and recapture these funds. Since 1983, in the last 6 years, 2,000 employers have raided pension plans to be recover $20 billion, jeopardizing the retirement benefits of 2 million workers and retirees.

As I said, I have been trying to do something about this for the last 6 years. In this Congress I have introduced S. 685, the Employee Pension Protection Act, which protects workers' fair share of pension plan assets. The key question in this debate has been: Whose money is it in these overfunded plans? The employers argue, we put the money in; therefore, it is our money. The employees argue, yes, but you put it in and you did not give it to us in direct wages; and so the 20 cents, or the 30 cents, or the 40 cents, or the 6 cents an hour that went into the fund was our money. We would have got it in higher wages. Employers argue that they should be permitted to take off with all the money. Workers argue just as strongly that it belongs to them.

After listening to both sides for years, I do not believe there is any clear answer. I cannot sit here and tell you it is this way or that way. Both sides have legitimate interests in their money. But I also believe that legislation is needed to protect the interest of workers and retirees in excess pension plan assets. That brings me

to the proposal to permit the transfer of assets from pension plans to retiree health benefits.

Both ERISA and the tax code—currently prohibit such transfers. Our Committees would have to agree to amend both to change the law. The issue has gained prominence, in part because the Financial Accounting Standards Board has determined that these liabilities should be reported on corporate balance sheets. If they are reported, they will show up as a major liability on the corporate balance sheet. This development has escalated the desire of employers to start funding retiree health benefits and now, to take the pension money away from the retired workers to do so.

Up until now, Congress has given little consideration to the complex policy questions that this proposal raises. Just like the termination and employer reversion issue, the transfer issue raises the same fundamental question: Whose money is it in those pension plans? Should money set aside for workers' and retirees' pensions be used to pay for existing employer liabilities? Should we be balance corporate books on the backs of retirees? Should we be trying to balance the budget by permitting the employer to use these funds to pay for retiree health benefits, thus leaving the corporation with more profits, thus providing more profits for the corporations to pay taxes on, thus helping us balance the budget?

I say that is crude. I say it is wrong. I say it is an abomination. That is not the way legislation should be drafted. To solve this critical problem by saying we are going to solve it by making the retirees accept the burden of the employers' responsibility, to me, is tantamount, almost to being criminal. It is not criminal because there is no law that makes it criminal. But absent that, it is as wrong as wrong could possibly be.

I do not believe that Congress has sufficiently considered this proposal; and, therefore, I do not believe Congress should permit the transfer of pension plan assets from ongoing plans at this time. To take these dollars away from the retirees, to give them no portion of it, to say we do not care what the merits are as to whose money it is, we are going to take the money away and we are going to give it to the employers to pay for their health plans—not even on the basis of the merit of that proposition, but on the basis that by doing it we can collect more taxes because they will not have to pay that out of their corporate profits. Therefore, they will be paying more taxes.

I think that is absurd. I think it is ludicrous. I think nobody understands what is going on or there would be an outcry throughout the country. I am a realist about the context in which this issue has arisen. I know that the Tax Committees are under severe pressure to raise revenue and that a transfer proposal is very tempting because of the money it saves. The Ways and Means Committee has already approved a transfer as part of its budget reconciliation recommendation.

I am willing to work with this Committee on the issue. I am willing to compromise. But any change in the law must ensure that both the pension and retiree health needs of workers are protected. Our Committees must consider the termination issue as well.

In 1987, as part of budget reconciliation, both our Committees agreed in conference on a proposal to protect workers' pensions

before employers could receive excess assets upon termination. Unfortunately, our agreement was deleted when we could not reach consensus on other issues. The termination issue has gone on for too long. To the extent that we are considering the use of pension plan assets on a ongoing basis, we also must resolve the termination issue. Even in the absence of an ongoing transfer, the termination problem still exists and must be remedied.

With respect to retiree health benefits, there are currently no standards for the provision of these benefits. We need some minimum standards to ensure that the retirees receiving these benefits are adequately protected.

In conclusion, I believe that the members of our Committees, yours and mine, must give very serious consideration to the issues at hand affecting both pension plans and retiree health benefits. Although I do not believe that pension assets should be transferred to retiree health benefits, I am willing to consider the issue. I am willing to compromise. I believe most strongly, we must ensure that the pension benefits of workers are protected both on an ongoing and on a termination basis.

Now is the time to finally resolve the termination and employer reversion issue. I stand ready to work with this Committee. But, Mr. Chairman, I hope that we do not have to go to the floor and make an issue of whether or not the Finance Committee has participated in a steal of pension assets that belong to retired workers. If they do not all belong to them, part of the money belongs to them. I do not believe that this kind of a decision should be made on the basis that by doing this we will reduce corporate liability; the corporations will, therefore, have more taxes to pay; therefore, we will help to balance the budget.

I think that is an unbelievable approach to solving an issue dealing with the daily lives of so many hundreds of thousands of retirees in this country.

Mr. Chairman, I am sorry but I feel strongly about this issue.

Senator BAUCUS. Thank you very much, Senator. I am curious, though, what more precisely is your solution. I mean it seems to me that the excess pension reserves would belong to lots of different groups. Employees certainly have a claim; retirees have a claim; and the company may want to increase its capital investment somewhere. There are all kinds of uses for reserves that accumulate and all kinds of uses that the company can put its profits to.

I am curious, then, what your solution is.

Senator METZENBAUM. Mr. Chairman, my solution is simple—we ought to compromise.

Senator BAUCUS. What is the compromise?

Senator METZENBAUM. Pardon?

Senator BAUCUS. What is the compromise?

Senator METZENBAUM. Well, I met with one Senator this morning who is not an ally of mine on this issue but thinks that the money ought to be used for retiree health benefits, thinks they ought to be able to be used for other purposes as well. I had said, let the retirees have 30 percent of the pension funds, hold back 15 percent of that amount for those who have not yet retired—that is, over and above the amounts that are needed to fund the present

pensions—and have 15 percent set aside for those who have already retired.

With respect to the other 70 percent, if you want to use them for health benefits, I have no problem about it. But I believe that something in that area—and I do not mention the 30 percent figure as a negotiating figure, I mention it because the Senator who came to see me on this subject, and with whom we were having a friendly discussion, had mentioned that 30 percent. He wanted to use the other 70 percent for—not only for health benefits—he wanted to use it for research and development, child care and for other employer obligations.

My feeling is that I am concerned about the retirees. I am a little less concerned about how the other portion of the money is used and whether the employer takes it home. But I believe that whether there is a termination, whether there is a new plan established, or whether there is withdrawal, that I think it is not unreasonable to ask that the retirees at least have a 30 percent amount set aside for cost-of-living adjustments and to see to it that there is coverage for future cost-of-living adjustments.

Senator BAUCUS. Thank you very much.

Senator Pryor.

Senator PRYOR. Mr. Chairman, right now I do not have any comments, in the interest of time.

Senator BAUCUS. Senator Durenberger.

Senator DURENBERGER. Mr. Chairman, I do not have any questions for our colleague. But I just want to relate to my colleagues on the Finance Committee how hard he has worked in the Labor and Human Resources Committee, just in the few months I have been there, to try to persuade all of us on this particular issue.

There are some of us who have prompted Howard to think well of other income security issues, such as health benefits. I think he is certainly open to that. But I can tell his level of frustration is getting fairly high because we have a markup tomorrow morning in the Labor and Human Resources Committee on reconciliation. And he and the Chairman have gotten together and they are starting to move.

So I would just say to my colleagues on this Committee that it is very, very important that we take this issue quite seriously and certainly, as we all know, take our colleague from Ohio very seriously because something is going to happen during the course of this year. While I do not agree with him on some of his specific proposals, I really must agree on behalf of the victims in my own State that we have fought together for—employees of bankrupt companies and employees of some other companies—that he certainly is to be complimented on his commitment to the issue of pension security.

Senator METZENBAUM. Thank you, Senator.

Senator BAUCUS. I appreciate that, Senator. You are absolutely correct. All of us on this Committee worked with the Senator on this issue in one way or another the last couple of years. I know when we were trying to put together the Technical Corrections Bill this issue came up in modified version. It is one of those issues that I agree has to be resolved in some way.

I appreciate, Senator, your diligence in trying to try to find a solution. I thank you.

Senator METZENBAUM. Thank you, Mr. Chairman.

I hope that we do not find ourselves in a position where we have to have a floor battle and see who has 51 votes. I have sought with the overall Chairman of the Committee to work out a compromise. I am prepared to try to do that in every way possible. I think that we would be serving our constituents if we can do that, rather than see who has 51 votes on a particular Tuesday.

Senator BAUCUS. You very well may be right. Thank you.

Senator METZENBAUM. Thank you, Mr. Chairman, and thanks to the members of the Committee.

Senator BAUCUS. Okay. Let's get back to our panel.

STATEMENT OF HON. RUSSELL B. LONG (FORMER U.S. SENATOR), LONG LAW FIRM, WASHINGTON, DC, ACCOMPANIED BY JEFF GATES, KELSO LAW FIRM, WASHINGTON, DC

Mr. LONG. Thank you very much for your kind introduction, Mr. Chairman and gentlemen of the Committee.

In terms of foreign policy——

Senator BAUCUS. Senator, you have probably been away from this Committee a little too long. That microphone does not work very well. You have to pull that very close up to you.

Mr. LONG. All right. Could I be heard better now?

Senator BAUCUS. Yes, even closer yet if you can, Russell.

Mr. LONG. How about that? Is that better?

Senator BAUCUS. You bet. Thank you.

Mr. LONG. In terms of foreign policy, someone must point out that even if the nation had no foreign policy at all, the lack of any position should be regarded as that nation's policy until such a time as a policy did emerge. On that it would seem that the United States supports a policy of extreme concentration of wealth. About 1 percent of our people own approximately 50 percent of all stocks and bonds. The next 14 percent own most of the remainder. Very little of it is held by the 85 percent in the majority.

Most Americans who own something have an equity interest in a home or an automobile. But the overall distribution there is nothing to brag about. The top 15 percent have about 85 percent; the next 35 percent own about 10 percent of our overall net worth; the next 35 percent own about 5 percent; and the remaining 15 percent own less than zero.

Why has Congress done so little to improve these relative numbers? If anything, the trend in recent years seems to be moving in a situation to make matters worse. Why has the Congress not at least required a study to enable us to keep score on how we are doing? If we could only agree that we need broader ownership and that we are willing to pay a price to move in that direction, even that would help. At least a previous Congress had made the interest expense on a home loan deductible and a previous Congress made it deductible from income for an employer to establish a pension plan, a profit-sharing plan, a 401(k) plan, a health plan, an ESOP plan, for the benefit of employees.

While some may complain about the increase in numbers of those in poverty during the Reagan Administration, President Reagan was a consistent supporter of ESOPs during his Administration. Much was done to increase the tax advantage of ESOPs—probably more than any other President.

Have we gone too far in that direction? Judging from the available data, one would hardly think so. In 1988 the U.S. economy undertook $741 billion of capital financing. Less than 1 percent of that was financed by way of ESOPs. Admittedly, the fear of raiders has caused more companies to establish or expand their ESOPs. But in view of the very small part of the economy that is in the ESOPs could we not at least wait until the 1989 figures are in before we cut back on ESOPs, rather than jumping to the conclusion that a very tiny relative shift in the economy is a matter of the gravest concern.

I am an advisor to Kelso and Company which owns controlling stock in 31 companies, none of which were financed by use of Section 133, thanks to the overly protective attitude of the Department of Labor. Everyone of our companies have ESOPs ranging from 5 percent to 40 percent. We are in it as a matter of dedication that goes back to Louis Kelso who first envisioned the ESOP approach. He is one of our Directors.

We are opposed to any abuse or unintended application of the tax benefits. We have demonstrated our sincerity about supporting this Committee repeatedly and trimming back on tax advantages where they were not intended. We stand by to help in that way again. As the original author of the provisions which this measure would amend, I doubt that anyone who serves on this Committee, or these two, certainly when I was a Senator, would doubt my sincerity in this matter.

We do not want anyone to abuse the legislation that we supported. However, we would like the opportunity to reason with the members and staff of the Committee before it drops a guillotine on something that may not be an abuse at all.

Let me just offer, by way of example, an illustration. The IRAs have been very popular. They were used far more than anyone anticipated. It cost the Treasury many billions of dollars beyond the original estimate. In due course, they were cut back to help pay for the 1986 Tax Reform Bill. But they had their day in court and they were not cut by the reconciliation bill which can be a short, sort of bums rush shortcut to the legislative procedure.

Now, let us look at Section 133. We originally passed that measure because banks, insurance companies and major lenders, generally, were not willing to even consider making ESOP loans. Thanks to Section 133 banks, insurance companies, and now many other lenders are not only willing, but anxious to make good ESOP loans. The potential use of the Section by investment banking firms like Merrill Lynch, Solomons Brothers, and Goldmman Sachs was envisioned from the beginning.

This competition among lenders can only assure that most, if not all, of the tax benefits will be passed through to the benefit of the employees. Already most of the benefit is being passed through to the intended beneficiaries—the workers. But there is still room for improvement. More competition among responsible, qualified lend-

ers can do nothing but help the program. Are some aware of abuses here, if not so, why not pull this on the abuse and correct that rather than throwing out the baby with the bath water.

If someone fears that a bank or other lender is charging too much, how can it do anything but help reduce the interest rate to subject that lender to a lot of new competition from other lenders. The proposed answer in the House bill was to abolish all future use of the Section. That is how it was introduced No showing was made of any abuse, much less consideration of how the remedy could be limited to apply to the area that needed attention. Even if the lender was passing through all the tax benefit, the answer was the same—off with their heads in any event.

Congressman Bill Anthony fought a valiant fight to save what he could. Unfortunately, the 30 percent rule was all he could obtain and this would kill the tax advantage for over 90 percent of the loans in terms of dollar volume and a great deal more than 90 percent of the ESOP companies in terms of numbers.

I am pleased to be a member also of the Lowes Company, which is an ESOP company and one of the "white hat" companies if there ever was one. By judging that company by a 30 percent test, however, Lowes would be in the category of those who had the black hats because it is not a 30 percent company. It was once a 48 percent company but the law required you to diversify the profit-sharing plan and now they are working up now to try to get back up to a higher percentage. But they would be some of the bad guys, rather than some of the good ones, by a 30 percent test.

I know that some may suggest a compromise with the House Bill. The problem is that the House conferees, headed by Carr and Rostenkowski can be tough. I well know that. If the Senate proposed a 15 percent rule compared to the 30 percent rule, for example, one would have little change of obtaining better than a 50–50 compromise, which would mean that you would have about a 22.5 percent figure, which in my judgment would still be far too high.

In my judgment, you will be compelled to compromise in conference so you will definitely needing a strong position in your direction from the beginning of the Senate.

Now let me speak to Section 404(k). This is in the House Bill, but still, thank the Lord, it is not in one of the Senate Bills that we are looking at here. The purpose of 404(k) was to encourage ESOP companies to pay out dividends to the employees or to accelerate repayment of an ESOP loan. Section 404(k) makes the dividend deductible so the employer, as would be the case of an employee's bonus or pay raise. Without the provisions, companies preferred to pay the money in ways that would be deductible.

There are several ways that the money could be paid. They could pay it, for example, as a bonus. They could pay it as a salary increase. They could put it in any one of the other many benefits, such as profit-sharing, and it would be deductible. But to enable the great majority of employees to know that they are holding something for their account or something of substantial value, a dividend from time to time helps enormously. It causes employees to be made aware of the value of their stock.

Believe me, I know from talking to the troops that dividend is a great moral and psychological booster. In some cases employees are not really aware of what they have until they see a check.

Finally, let me discuss voting rights. I do not really think the amendment is necessary. ESOPs are overregulated both by the Department of Labor and by Treasury as it is. For example, to install a ESOP your company is almost guaranteed that it will be audited by the Internal Revenue Service. That is enough to deter a lot of companies right there.

But I would most strongly urge that the voting right provision should not be extended to the many small companies, most of whom would not put in an ESOP for fear that the employees, or their representatives, might find themselves in conflict with the management. Under the law it stands, employees are sure they pass through their voting rights, even in small companies where the so-called major issues are concerned. In a practical matter that usually includes everything except the election of the Board of Directors.

However, some of the small companies fear that a tough labor leader might see it upon the voting rights to dictate a policy that management cannot accept. Thus, bringing discord to a program that was intended to bring better understanding.

There is one situation, however, where I do strongly favor a requirement of pass-through voting even to small companies. Wherever a takeover, merger or sale of the company is involved, I think the employees should be able to require that that stock be voted to protect their interest which is usually their interest in saving their jobs. In that case, I think that the trustees should be required to vote both the allocated stock, as well as the unallocated stock, of the ESOP as the workers desire and they should inform him in a confidential sealed communication.

To do otherwise is to deny the employee shareholders the right to vote to save their jobs. That may be all that stands between a man and poverty. In that particular situation, an employee's right to vote might mean more to him than the stock itself.

Mr. Chairman, I do not say that ESOP will solve all of our problems, but it will solve many. It should be a accompanied by the best of management policies to dignify the employees and to make them know that they are appreciated. Employee participation is very important. But not everybody can be expected to do all the right things at one time. We will make more progress if we let ESOPs and employee participation sell themselves on their own merits. It would be a shame to lose either by insisting on both simultaneously.

I have been working in the ESOP vineyard for 16 years—since the night I first met Louis Kelso. I expect to do whatever I can to help as long as I can be effective. It seems to me that the ESOP approach can help make our system one where we can apply the golden rule as a standard and it will be just as good for us as for our neighbors.

Mr. Chairman, because of the time constraints I would like to comment on some other Sections and ask a request to file a supplemental memorandum to support that.

Senator BAUCUS. Thank you very much, Senator.

[The prepared statement of Mr. Long appears in the appendix.]

Senator BAUCUS. Mr. Koch, you are next.

STATEMENT OF STEVEN R. KOCH, VICE PRESIDENT/TREASURER, THE PEORIA JOURNAL STAR, INC., TESTIFYING ON BEHALF OF THE ESOP ASSOCIATION, PEORIA, IL

Mr. KOCH. Thank you, Mr. Chairman. I am Steven Koch, vice president and treasurer of the Peoria Journal Star. I am also treasurer of the Employee Stock Ownership Association, headquartered here in Washington. I testify today for our 1,100 ESOP member companies.

Before discussing the issues pertaining to S. 1303 and S. 1171, let us note that leveraged ESOPS are involved in a small percentage of corporate debt transactions—2 to 3 percent since leveraged ESOP tax incentives were adopted in 1984 to the end of 1988—representing 5 to 7 percent of the value. Even this year, when the number of ESOPs created by public companies increased greatly, the percentage of ESOP transactions to all debt transactions is approximately 10 to 15 percent of dollar volume.

During the recent Ways and Means Committee hearings on LBOs and corporate debt, many witnesses voiced support of employee ownership and ESOPs—including the Secretary of Treasury, Chairman of the Federal Reserve Board, and President of the AFL-CIO. Yes, they cautioned about revenue loss but they were for employee ownership.

We believe Senator Bentsen's Bill reflects this attitude and we are appreciative of his approach to the current debate over ESOPs. We do not support in any way S. 1171 which would repeal the 50 percent lender interest exclusion.

As to S. 1303, the ESOP Association does express reservations about the 30-percent threshold. Our large publicly-traded members make a convincing case that 30 percent or more threshold requires too much leverage, adversely affects their other employee benefit plans, and triggers a variety of outside shareholder concerns. If the Committee decides to adopt a threshold affecting publicly traded companies, please consider a smaller threshold.

Why is the ESOP lender partial interest exclusion so important? Before the provision became law leveraged ESOP companies were few in number. Of the few with significant payrolls only a handful were strong, growing companies. Current provisions in the law provide smaller companies equal competitive access to capital with the major financial players on Wall Street.

Now I turn to the second major part of S. 1303—the mandate for full voting rights pass through. Publicly-traded corporations are not affected by this issue. Closely held corporations are required to pass through voting rights for most major issues, except for the vote on the Board of Directors. The vast majority of our ESOP member companies were small business, closely held companies where the proprietor would have been extremely reluctant to pass through full voting rights as the result of the initial ESOP transaction. We endorse continuation of the provisions of current law.

Turning to another subject, we turn to the matter of the ESOP dividend deduction. The ESOP Association supports maintaining

the dividend deduction as is. The dividend goes directly to the employee in cash or more stock. It has led to the use of convertible preferred stock with high dividends, highest voting power and set conversion price. Because it does not fall under 415 limits, corporations can maintain other benefit plans. Even with the increased creation of ESOP, the ESOP dividend revenue costs are only about 25 percent of those arising from the lender interest exclusion.

We urge you to maintain the position implicitly set forth in S. 1303—no change in the ESOP dividend deduction. Why do we want to defend ESOPs? Why do we believe? As an employee of an ESOP company, I can tell you why. The Peoria Journal Star publishes the largest daily newspaper in Illinois, outside the city of Chicago. In December of 1986 we borrowed $25 million to finance a transaction increasing the employee ownership of our company from 25 percent to 82 percent. This stock was purchased at $71 per share and is currently appraised at $125 per share. A 76 percent increase in value.

Given the 1987 stock market crash, I defy anyone who claims our employees would be better off with a diversified Wall Street portfolio. We have paid to date $7,880,000 in dividends to reduce this $25 million debt. The current appraised value of allocated ESOP shares is $40,218,000. That is an average account balance in our company of $85,000 per employee and that is 4 years after our ESOP has been formed.

For employees leaving the company, mainly retirees, we paid $4 million in benefits in 1987 and 1988. We will pay another $2 million this year. Do not tell me that the Peoria Journal Star and our employees are not benefiting from the ESOP Tax Code provisions provided by you the members of Congress.

All over the world people struggle with this concept of ownership. More and more people want to turn away from owner- ship by the State or ownership by a few. So far, only the ESOP, thanks to Senator Long, under U.S. laws and regulations represents a successful model for addressing either concern. While we know that midcourse adjustments in employee ownership laws may be needed we submit overall we are on the right track.

We appreciate your attention and we appreciate that we address ESOP issues with you in a collegial manner and not in an adverse way.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Mr. Koch.

[The prepared statement of Mr. Koch appears in the appendix.]

Senator BAUCUS. Mr. Huard.

STATEMENT OF PAUL R. HUARD, VICE PRESIDENT, DEPARTMENT OF TAXATION AND FISCAL POLICY, NATIONAL ASSOCIATION OF MANUFACTURERS, WASHINGTON, DC

Mr. HUARD. Thank you, Mr. Chairman. I am Paul Huard, vice president of the taxation and fiscal policy department of PNAM. We appreciate the opportunity to present the views of our more than 13,000 member companies on this important matter. Since I do not find myself in marked disagreement with anything the prior

distinguished panelists have said, I can summarize my comments fairly briefly.

We oppose any restriction on the current interest exclusion for ESOP loans. We support maintenance of the dividend deduction provision as it is. If there is to be a compromise in this area, and an ownership threshold is to be instituted, we think 30 percent is much too high. That probably you ought to be thinking, at best, in terms of single digits. As a practical matter I guess to summarize our position on ESOPs, we support the retention of all provisions now in the Code to encourage and facilitate ESOPs and we oppose any changes that would detract from the formation and maintenance of ESOPs.

We think ESOPs are helpful and more widely disseminating the holding of wealth in the United States. A number of studies have suggested that companies with ESOPs have better performance productivity characteristics than those that do not. And in general, we believe the policy changes in this area should be driven by consideration of what makes good sense in terms of employee benefits, what makes good sense in terms of motivating employees to be more productive and make their companies more competitive in international markets and not my considerations of arbitrary revenue numbers needed to satisfy a reconciliation instruction.

If I might briefly diverge to the topic of the next panel, we would also like to compliment Senator Pryor on his introduction of S. 812 which would both provide tax favored treatment for the prefunding of retiree health care and facilitate the use of surplus pension assets for that purpose also. We support that Bill generally as the correct way to go. We believe that providing tax incentives for employers to furnish and adequately fund employee benefits is the way to go in this area, not the mandating of benefits as has been suggested in some areas under consideration by the Senate and the House.

Thank you.

Senator BAUCUS. Thank you, Mr. Huard.

[The prepared statement of Mr. Huard appears in the appendix.]

Senator BAUCUS. Gentlemen, I would like to know from each of you which of the various ESOP tax provisions provides the greatest incentive first to forming and creating an ESOP and second, if there is any difference, in maintaining that ESOP. There are many provisions in the Code which directly affect ESOPs. The two we are discussing this afternoon are 404(k) and Section 133. There also is Section 2057 and there are others, too.

But which of the present provisions has the greatest incentive in the creation of an ESOP. That is, if an ESOP is to be formed, when the potential creators look at the various provisions in the Code, which provisions in the Code have the greatest bang for the buck? Let me start now with you, Mr. Huard.

Mr. HUARD. Well, I am going to have to borrow Mr. Trier's approach from Treasury. We have not looked at it that way and I, frankly, could not provide you an answer. I would be glad to go back to my staff and think about it and try to provide a response for the record.

Senator BAUCUS. Could you please?

Mr. HUARD. But right off the top of my head, I do not know.

Senator BAUCUS. If you could, please.

Mr. Koch.

Mr. KOCH. Senator, I would say they are all rather equally important in terms of creation for the privately held companies.

Senator BAUCUS. Right.

Mr. KOCH. Access to capital is terribly important. It was extremely limited prior to the interest exclusion. Because at that point in time you could not really competitively compete with the IBMs and the AT&Ts of the world for capital. It opened a much broader base of access of capital. I think the dividend deduction is quite important. Because of the 415 limitations, as an ESOP matures, particularly again in the privately held companies, the repurchase liability becomes a very significant factor.

In certain given sets of circumstances, the 415 limits just cannot handle that situation. So it is very important from that standpoint. It also provides many companies, such as ours, the ability to continue a defined benefit plan in conjunction with an ESOP. So I just do not think we apple pick or cherry pick. I think they are all equally important to us.

Senator BAUCUS. Russell.

Mr. LONG. Mr. Chairman, I would have thought in the beginning that the Section 133 would be more important because at that point to engage in leveraged ESOP operation we had difficulty obtaining financing. And even in the long run, I think due to the fact that the more favorable loans are available because of Section 133, in the long run will do more for the benefit of the workers than the other Section.

If asked the question in terms of influencing people to organize an ESOP. On that basis, I think that Section 404(k) would do more. Because when someone comes up with the idea that this company ought to have an ESOP and he wants to sell the idea to the other corporate executives, usually it is not going to happen unless you can get the Treasurer, the guy that keeps the books for the corporation, to put his stamp of approval on it. When you tell him that these dividends are not deductible; that you are going to pay double taxation on it; he is looking at the competing employee benefit plans that he could put his money into—every one of which are deductible all the way.

When he gets told that the dividends are not going to be deductible, that really chills him. He is inclined to say, look, if we cannot deduct it, sorry. I can give these people a bonus and I could deduct it. We could give them a pay raise and we could deduct it. We could give them a pension plan and we could deduct it. We could even give them profit-sharing and deduct it. We can give money all kinds of ways and deduct it. But if you are going to do it by way of a dividend we are going to pay a corporate tax and they are going to pay an individual tax. So, no, I am not in favor of an employee benefit that is going to be taxable to the corporation.

So I think that the repeal of Section 404(k), dollar-for-dollar in terms of which gives you the biggest bang for the buck, would probably keep more employee stock ownership plans from being put in place than the other one.

Senator BAUCUS. I do not mean to put words in your mouth, Mr. Koch. But in your testimony you indicated that perhaps you could

live with some kind of adjustment to Section 133, but I think I heard you say no change in 404(k). Does that imply, perhaps, the deductibility of the dividends is perhaps more important?

Mr. KOCH. Very much, Mr. Chairman.

Senator BAUCUS. Okay.

Do any others of you have any questions or points you want to make on this that have not been raised or in responding, say, to Treasury?

Mr. LONG. Well, the one point we had not touched on, Mr. Chairman, that I thought I would mention if I had a chance to—85 percent of Americans put together—have 15 percent of the nation's net worth. So when that 85 percent reaches retirement age, they are not going to have much. In fact, 50 percent of them, as individuals, will not have more than a few thousand dollars of net worth that they can say grace over. So they are not going to have anything but that Social Security check, perhaps a private pension, depending if they have a pension program that they can look to.

Now where the employees are in on an ESOP plan, that savings that is accumulating down through the years, and if they work hard and make their company succeed as they tend to do when they have a substantial stake. What they have could be worth $100,000 per worker. It could be worth $200,000. Some of them will get lucky and it will be worth $1 million.

As an example, I am on the Board of Lowes Company. A longtime employee, who has been there for let's say 25 years and become a store manager, will retire with over $1 million. Now how is he going to get lucky any other way to have the best of it?

You know, all kind of people sit around and hope that at some point something will come their way—maybe they will win a lottery or something. At some point, maybe something will come their way. I can think of a dear old man I knew very well and loved very much who was hoping that he could leave his family $1 million when the Good Lord called Home. Well, as it turned out, he merged a little company to a bigger company and it increased in value ten fold, at the latter point, he was in a nursing home and not able to even communicate with anybody when it happened. But he did leave $1 million estate to his family. Something came his way. It was his good judgment that caused that to happen.

For most people, what is their chance that they are going to do very, very well indeed and be able to take their family or wife on a trip around the world or enjoy some good things in the golden years? The one thing that will do it for them if they have an ESOP is that they might be in a very successful company.

Some companies, Mr. Chairman have been known to increase in value 1,000 to 1. Some companies have increased in value 3,000 to 1. Think what that meant to someone if they had a piece of it. But some companies have been like that. In most of such cases, none of those employees walked with a lot of money. The companies said, thank you; it has been nice knowing you, and gave the employees gold watches or something like that after they had worked the last time for a company.

The one advantage of employee stock ownership, if they have that chance, they might really be very, very fortunate and they contributed to that good fortune.

Senator BAUCUS. You make a good point. In your best judgment, what would the consequences be of the bill introduced by Senator Bentsen for the creation of ESOPs? How would it affect the redistribution of America's wealth.

Mr. LONG. Well, that is hard to say. But with that 30 percent threshold, 90 percent of the companies are going to be discouraged if you just do that. Now that is not saying they will not go into it. Some will and some will not. But more than 90 percent, maybe 95 percent of the companies, will be discouraged from going into it because it was not as favorable as it was before.

There is something else that is going to discourage them too. You look at the trend of what has been going on. Now I supported the legislation that picked up more than $2 billion where we cut back on a provision I had offered myself to try to make the estate tax more favorable if you sold your company to the employees.

Senator BAUCUS. That is right.

Mr. LONG. So that I can understand should have been cut back—not near as much as it was, by the way. But it should have been cut back because no one had in mind how some imaginative people could take advantage and abuse that Section to achieve advantages that were never intended. But you look at the trend where like in——

In 1984 the ESOP program was cut by $2.5 billion by scaling back the tax reform ESOP. In 1986 it is cut by $2 billion terminating the paysop provisions early. I proposed that myself. But with that, as a trade off against that, we got some of these other provisions that we are talking about here, that I thought would give you a bigger bang for the buck—along the lines that you are discussing. In 1987 about $5.4 billion by changing this estate tax provision.

Now in 1986, Mr. Chairman, you were the good guy. You came up with a proposal that saved $100 billion for the Treasury by having to do with pension reversion and reforming in that operating loss provision. I understand why and I support your position. But people looked and said, well, look, Congress keeps cutting back on all this. Now here's another $2 billion here. By the time we get into this thing, is there going to be anything left of it.

Wouldn't you be wondering if you had the decision to make as an executive—should I get into this thing—is it going to be here 10 years from now or even 5 years from now? This is a long-term program. Wouldn't you wonder if it is going to be there when the time comes?

Senator BAUCUS. That raises one other question. Which of the alternatives do you generally prefer? That is, better transition relief or longer term provisions?

It comes down, unfortunately, Mr. Huard, to a revenue question. This Committee is faced with a bit of a tradeoff between more lucrative transition relief on the one hand and changing the longer term provisions more favorable to ESOPs on the other.

Mr. LONG. Mr. Chairman, I am a religious person and I give the Good Lord credit for a lot of good things that have happened that I could not anticipate at the time. If something happens that is very predictable at this moment—when you come back here in September and this matter has not been finally decided and you look at

those new tax collection numbers, you may find that none of this is necessary at all.

Now the Treasury's testimony looks like they are all for ESOP, but the Treasury needs money so they are for cutting back on the benefits. But if you come back here and you find that through the new revenue figures, your budget, it is already achieved, then what is the point in passing this?

Senator BAUCUS. With respect to the trade off, if we are faced with a trade off, I am just curious to what the panel's reaction would be.

Mr. KOCH. Mr. Chairman, we really have to think long term for those of us who are in it and for those who we hope will be coming into it. That is more important.

Senator BAUCUS. Thank you.

Mr. Huard, any reaction?

Mr. HUARD. Not appreciating the choice, I would say that the more important thing is properly structuring a long-term program that employers can rely on to be there and not to be tinkered with every 12 to 18 months, which is all we have been doing since 1981. But again, I do not particularly appreciate the choice.

The only tax increase we would support as a deficit reduction tool is the kind of increase you get from increased economic activity, such as by cutting the capital gains tax rate.

Senator BAUCUS. That is another matter. Thank you.

Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Senator Long, I know and appreciate very much your long-term work in this area. I am delighted, Mr. Koch, to know of your interest in this and your involvement in an ESOP. Mr. Huard, it is good to hear your testimony, too.

Senator Long and I have a special relationship concerning ESOPs, and especially because of Weirton Steel. You talk about Mr. Kelso. You knew, I think, Mr. Long, my father who was very much unlike my Uncle Nelson and was a rather quiet man, not inclined to talking or writing much. But he did, in fact, write one book about his life called, "The Second American Revolution."

In the book, he noted his own interest in Mr. Kelso's principles and the idea of spreading the rewards of production more evenly among the work force. So I feel, obviously, a strong tie to my father on this goal; and I feel a very strong tie to you because of your leadership and also because of your very direct participation in the success of Weirton Steel, which is the country's largest industrial ESOP.

Now people often refer to successful ESOPs, and then they say, yes, but they are an exception. Now I want to ask you, if I might, sir, a few questions literally for the record. There are thousands of ESOPs that have been created—benefitting some 10 million workers. I wonder how you would characterize how they are doing generally in this country?

Mr. LONG. In general, I think they are doing well. I hear people talk about the abuses. They have yet to show them to me. Now with 10,000 of them out there, you may very well find one of them that is not being run the way it ought to be run. But most of

them—practically every one I know about—is being handled well. I do not know any in Louisiana that is not being run well.

Senator ROCKEFELLER. Thank you.

Mr. LONG. There is a whole long list of ESOPs. The Association gave me a list as long as both your arms put together of the number of ESOPs, with which they are familiar and doing a very good job. So I would say the answer is that they are doing well. But now someone might show up with some exception. I am not here to say that they might not be. In 10,000, I should imagine that you can find a bad apple somewhere.

Senator ROCKEFELLER. Thank you, Senator. Again, for the record, your view on the 30 percent threshold being considered today?

Mr. LONG. Well, it is my impression that the effort here started with the idea that the Senator wanted to have a good ESOP/bad ESOP bill so that the good ESOP would continue to get the benefit of Section 133 and the bad ESOPs would not. Well, I can agree that Weirton is a good ESOP; Avondale Shipyard is a similar one of a high percentage of ownership. I believe that to be a very good ESOP. I was down there just a few months ago. But I do not think that that 30 percent necessarily means that one is good or not good.

As I mentioned, I am on the Lowes Board. That is one of the older ESOPs. As soon as they knew what ESOP was they decided that that is where they ought to go with their program and that is a very good ESOP. All the books written about it said they are very good. I think, like others, they could improve on their employee participation part, but they are very good at that already. But that is less than 30 percent—less than 25 percent. And that is a very well run ESOP.

I couldn't for the life of me understand why if you wanted to make a list of good ones you would not count that as one of the good ones. Incidentally, the man who is the Chief Executive Officer of that company was elected President of the ESOP Association. I think they partially recognize his success as a good corporate executive running a good company.

Senator ROCKEFELLER. Sometimes it is necessary for an ESOP, as in the recent case of Weirton, to reduce the percentage of its portion which is under the ESOP in order to raise capital to maintain the strength of the overall ESOP; is it not?

Mr. LONG. It certainly is. That is right. If that is necessary I would say that they should by all means do so.

Senator ROCKEFELLER. The lender interest exclusion benefit employees——

Mr. LONG. By the way, Senator, I might say that at Avondale we had one that started out at about 100 percent ownership in a shipyard. In order to modernize their shipyard they sold 40 percent stock interest in their company. Within a few months the stock had gone in price by 100 percent. So everybody is happy about it—the new stockholders, as well as the existing shareholders of the shipyard.

Senator ROCKEFELLER. How does the lender interest exclusion benefit employees and what was it that you had in mind when you asked Congress to adopt this particular provision back in 1984?

Mr. LONG. At the time we did that we were hoping to persuade the lenders to make the loans. They are making loans. And may I say also, Senator, that my philosophy when I went into this thing in the beginning was that, if you put enough tax advantages into something you can achieve just almost anything. Just like I think that within this Committee, you have it within your priority to see that very few people in this Nation would ever die poor if you want to pass enough good legislation here to see that that result would not happen. That is what I had in mind when I started out to begin with to say that, why do we have such a poor distribution of worth.

I think that as your father suggestion, and as I am suggesting, I do not want to play Robin Hood with anybody. I do not want to take away from anyone what they have. I want to see them—I do not know of anybody I do not feel kindly toward. I would like to see them all increase what they have. But I would like for them not to be such pigs about the matter that nobody else has much to benefit themselves.

So this government can adopt policy and this is one of them. Like I say, it is a prime example of it—where the employees own stock in the company and over a period of time—mind you, not by compelling them to do it, but where they voluntarily put in the plan where the employees have a much more dignified status in the company. They all consulted; they participate more in what happens; and then they participate in the company's success so that if things go well they can all be very well off indeed.

Senator ROCKEFELLER. Let me ask you another question.

Mr. LONG. So my thought is that if you do enough to encourage this thing—to make it a good deal—it ought to go a long ways. Now you can talk about what Section 133 had done. I hate to say what I am going to say next but I am afraid it is true. A lot of this present forward movement that has these people all upset is because people are putting in ESOPs because they think it might help them fight a takeover. I am sure you have heard about that, Senator. Some people are worried about that.

Just because you put the plan in, though, does not mean those employees are going to vote for you. They have a right to vote on who is going to buy the company. In the Pillsbury case, for example, the majority of those employees, the majority of that stock owned by employees would go for the takeover—for the tender offer—so that, do not put the plan in just assuming those guys are going to vote for you. You better go talk to some of those troops and see if they are going to vote for you, if they have some stock to vote. Because if they do not like you, they will probably vote for the other guy.

Senator ROCKEFELLER. There have been studies that indicate that only 7 out of 100 American workers think that if they work harder that there will be some benefit to them. This is not what we want to be hearing out of our Nation's workplace. Yes, they think that there will be a benefit. But they see it going to the stockholders, to the plant managers and——

Mr. LONG. Say only 7 percent?

Senator ROCKEFELLER. Seven out of a hundred—7 percent.

Mr. LONG. That is very discouraging.

Senator ROCKEFELLER. It is very discouraging. In Japan, 9 out of 10 Japanese workers think that if they work harder that they, themselves, will benefit. Now how do you think employee ownership can be used to better tap into that sense of the productive energies of our workforce?

Mr. LONG. I do not know of anything that more increases a worker's confidence than to say that you want him to be a partner, and in effect, being a shareholder does make a partner of him.

Now we have talked about the desirability of voting. I am all for the voting, except insofar as it might tend to keep the ESOP from being put in there in the first place. That is why I want to keep it the way it is as far as small companies are concerned. But even there they vote on the major issues. So the fact that their vote makes a difference.

As I indicated last in my statement, I do not want to require that you have an employee-participation program, just like I do not require that you have an ESOP. I would not require that you have one in order to have the other. But to get the best results you should have both. An employee ought to know that he is appreciated; he ought to know that his work is being watched and he is being evaluated. And if he deserves it, he is going to get a pay raise or a bonus, or some consideration right along.

Then you ought to put on a party, for the employees about once a year. I have seen cases where the plant manager would get up there in one of these cage type things sitting over a big tub where somebody would throw a ball, hit the target and the guy drops into the tub of water and takes a ducking. But people go away saying, hey that guy is a swell fellow. Can you imagine the bosses letting the guys do that to him?

Those type things where the employees are treated as though they are members of the family. Just do a great deal to make people feel that they are being considered, their interests are being taken care of, and if they do a good job they are going to get a bonus or pay raise or both and they are going to get ahead.

Senator ROCKEFELLER. I want to expand on that because I strongly agree and I also want to ask Mr. Koch's opinion on this. ESOPs get their name, you know, for the broadening of ownership, and that is absolutely essential. It is widening the circle and enlarging the amount of stock that is owned by people in this country.

But there is this other aspect and that is the whole business of what you are referring to—participation, collaborative management—and I think that in the longer term of ESOPs that is fully as important as is the increase in employee stock ownership. I would wonder if both of you gentlemen, or three of you gentlemen, would simply comment on that—affirming it or commenting on it as you might wish.

Mr. KOCH. I can only speak directly for our own company, Senator. But it is not something that happens overnight, obviously. We have been in our program now going into the fifth year. Our employees are now really thinking like owners. You know, in the beginning we really did not quite understand what was happening. I was kind of directly involved in the formation process and even I did not realize.

But, we have members of our Teamsters truck drivers group coming to us suggesting how we ought to reroute our routes to save money. We have people in our composing room making the same type of suggestions on how we can more effectively operate in that area.

We have seen—we had a market place in Peoria that went through some very depressed years. Our major industry there, Caterpillar, had some tough times for a few years. Fortunately, that is not the case today. They have recovered and weathered that situation very nicely. We see our ad sales people out there selling as owners now, not just as order takers.

You know, this question always comes up—productivity. We did not need to bring in a lot of fancy experts to tell us how to set up quality circles and this sort of thing. It has just kind of happened. It is happening in a real positive way in our company.

Does that answer your question?

Senator ROCKEFELLER. Yes, it does; it is helpful to me.

Mr. HUARD. I certainly think that the concept of giving the employees a piece of the economic pie is important, not just for improving the distribution and wealth, but perhaps even more importantly for giving them an incentive to be more productive and to make their companies more competitive.

We have not done any fancy, scientific studies either. But it seems to me that—Well, I know that when I was a partner in a law firm I worked a damn sight harder than when I was an associate because I knew I was going to get, you know, a certain percentage of the billings and the profits. Even though that is anecdotal, I frankly think that for the average employee, if he knows he is going to see something come back, he is going to work harder; he is going to think more about the success of the company, you know, instead of just thinking about punching out at 5:00.

Senator ROCKEFELLER. Yes. That is not exactly what I was referring to though. That, again, is the economic incentive. The other is, in fact, the collaborative style of management—where the organization takes on a different nature because of the philosophy of its management, in addition to the economic gain.

Mr. HUARD. Well, you know, I would think that there is probably an excellent, you know, prospect that that would happen. But I have to say that I was trained as a tax attorney and not an industrial psychologist. I just do not know.

Senator ROCKEFELLER. I understand that, sir.

Senator Long, do you have any comments on that? I was just hoping you would.

Mr. LONG. In my Senate office told me the latter part of my term—I guess about the last 6 years I was here—we just had the good fortune to bring aboard a lady who was very good on dealing with personnel matters. She had not necessarily been educated in that area, but had taken an interest in that type thing throughout her employment career, by just having the kind of practices where everybody's service is evaluated and discussed with their fellow workers. Each person is rewarded, at least once a year, by being considered for a pay raise, a bonus, or both, or a promotion as well.

We never had any problem—be it a problem that they are causing or a problem that comes their way that they had nothing to do

with—that was not dealt with. Someone was there in a responsible position to look after it. Be it a matter of going by to see how they are doing when they are sick or calling somebody to say, now look, you have to get your family better organized. You cannot be receiving calls all day long here at this office.

But good personnel practices, make a person feel that the employer really has a real interest in the employee and that the fellow workers have a real interest in that employee. Good personnel policy makes people willing to come earlier, work later, work harder, do a better job and be glad to do so. And they are happier doing it. So that there is no substitute for any of that. And in time, I think we will learn more and more and it will be the practice in almost all companies.

Just like the idea of having a piece of the action makes a great big deal of difference. In Houston, Texas—you have probably read about this or saw about it—I would like to meet this fellow by the name of Gordon Cain, who organized a chemical company. He is enormously successful. I am proud of the fact that he was a graduate of Louisiana State University, but I do not think he was on the campus when I was there.

This fellow made hundreds of millions of dollars over a short period of time. He had the employees in for about 20 percent?

Mr. GATES. Less than 20.

Mr. LONG. Less than 20 percent of the action. They walked away from there in less than a year with an average of $100,000 a piece.

Mr. GATES. Thirteen hundred.

Mr. LONG. For 1,300 employees, $100,000 a piece. Now those people are in a position to be capitalists. They can start learning how to be a money manager and invest money and make good use of it if they are wise enough to do it that way.

The story I read said that they worshiped that guy as though he were a god. I guess you could think that people should and would. But he must be a very nice fellow in addition to that. If I made my gang $100,000 a piece, I think they would all like me pretty much, if in addition to being well paid, I made them $100,000 each in a year.

But now think, by contrast, think of all these people we talk about who made a lot of money and did not do anything for those employees, except just pay them a salary. There is a great big difference. Incidentally, that fellow told Mr. Gates, who is sitting beside me, that in his next endeavor he expected to do the same thing all over again. He just thinks that is how you ought to do it—you ought to have the employees in on it.

Wouldn't it be good if we could sell that to the business community in general? So far we have made some headway. A lot of them are putting these plans in.

Senator ROCKEFELLER. I agree with you, Senator. I thank you, as I do all three of you gentlemen, for your patience in being here and for your great healthfulness. Thank you very much.

Mr. KOCH. Thank you, Senator.

Mr. HUARD. Thank you, Senator.

Senator ROCKEFELLER. The final panel consists of Dr. Steven Schanes—I hope I have pronounced that correctly—the Worker

Equity Volunteer, American Association of Retired Persons from San Diego. Did I pronounce that correctly?

Mr. SCHANES. It is pronounced Schanes.

Senator ROCKEFELLER. That is what I said. Yes, good.

And also, Mr. John E. Stair, Jr., manager, employee compensation and benefits division, DuPont, testifying on behalf of the Coalition for Retired Income Security, Wilmington, DE.

Mr. Stair, would you care to proceed.

STATEMENT OF JOHN E. STAIR, JR., MANAGER, EMPLOYEE COMPENSATION AND BENEFITS DIVISION, DuPONT CO., TESTIFYING ON BEHALF OF THE COALITION FOR RETIREMENT INCOME SECURITY (CRIS), WILMINGTON, DE

Mr. STAIR. Thank you, Mr. Chairman. My name is Jack Stair. I am a manager in the employee compensation and benefits division of the DuPont Co. Today I am testifying on behalf of the Coalition for Retirement Income Security—or CRIS, as it is known.

CRIS is an ad hoc group of large corporate sponsors of soundly funded pension plans that also provide health care benefits to their retired employees. Members include representatives of a variety of industries, including telecommunications, computers, chemicals, oil and manufacturing.

We commend the Subcommittees for conducting this hearing and thank you for inviting us to testify. We also wish to applaud the legislative efforts of Senator Pryor in this crucial area. CRIS member companies are committed to providing retiree health benefits and believe enhancing the security of those benefits is dependent upon prefunding.

Moving to prefunding is a two-step process. One step would permit the transfer of excess pension fund assets into a 401(h) account within the pension plan or into a retiree medical trust. The second longer term step would be to provide companies with incentives to prefund for retirement health benefits.

The CRIS proposal is a limited one which deals solely with the transfer of excess pension fund assets to secure the health benefits of current retirees. Four key features of the proposal are as follows:

(1) Excess pension assets determined on a basis which includes a reason cushion over the amount required for current pension liability should be available for voluntary transfer, solely to pay health plan benefits for current retirees.

(2) Transfer would not be subject to income, excise or any other tax, and would not force vesting or annuitization of pension liabilities.

(3) Assets transferred would not be subject to income tax or unrelated business income tax.

(4) Transferred assets could never exceed the present value of unfunded retiree health liabilities as adjusted by medical inflation.

The CRIS proposal provides advantages to retirees, to employers and to the government as follows: Our proposal enhances benefit security for retirees by dedicating assets for retirement income security. With funds set aside, and a dedicated trust, the future retiree health care benefits would not be dependent upon the economic health of the plan sponsor. Retirees would receive enhanced securi-

ty in an era of corporate takeovers, both through the dedication of transferred assets solely toward retiree medical benefits and through the reduction of surplus pension assets that often encourage takeovers. Pension benefit security remains intact by limiting the amount eligible to be transferred.

Employers would benefit from increased cash flow as benefits would no longer be paid from operating assets, thereby stimulating investment and enhancing U.S. competitiveness.

The CRIS proposal, in the form that we recommend, would also significantly increase tax revenues because transferred assets would be the source of retiree benefit payments. Thus, employers would not continue to take tax deductions for those payments. The Joint Committee on Taxation's estimate shows that tax revenues would increase by approximately $3.2 billion over the 1988 to 1992 fiscal years if the CRIS proposal applied throughout that period.

Without question, the revenue increase to be gained from this proposal is highly dependent upon the extent to which companies are persuaded to use that source of funds. The Subcommittee should be aware that the requirements added to the CRIS proposal, which have been included in the pending Ways and Means document, would substantially reduce or eliminate expected utilization.

As a consequence, CRIS believes that virtually no revenue impact will result should the Finance Committee follow a similar path. In particular, the Ways and Means mark requires that all plan participants be fully vested in accrued pension benefits and that all pension plan benefits be annuitized. In other words, that assets equal to the termination liability be invested in annuity contracts.

It is our understanding that such additional requirements were added to protect the security of promised pension plan benefits. While such goals are allottable, such requirements are unnecessary and would only be appropriate when a pension plan is terminated.

The unworkability of the Ways and Means mark can best be illustrated by an example. Assume that a company's total pension assets equals $200 million, pension termination liability equals $125 million and annual retiree health expenses equal $5 million. The proposal included in the mark would restrict the retiree health transfer to $10 million—that is 2 years of retiree health expenses.

Moreover, to gain this mere $10 million cash flow advantage, the employer would be required to vest and annuitize $125 million of pension liability.

We also point out to the Subcommittee that the Ways and Means mark differs from the CRIS proposal in other material respects. First, the Ways and Means version limits transferable amounts to only 2 years of retiree health care costs, rather than lifetime costs. Second, the Ways and Means would require a pension plan cushion of 140 percent of current liability, rather than 125 percent, an amount which the Department of Labor has found adequate for purposes of pension fund security.

To conclude, the Coalition's proposal represents an important first step toward the goal of providing benefit security for retirees. It is also advantageous to employers who have responsibly funded their retiree pension plan benefits because it improves their cash

flows; and as originally offered by CRIS, our proposal is also advantageous to the country because it raises tax revenues.

However, as I have discussed, the desired new revenue will quickly evaporate if restrictions such as those suggested by the Ways and Means Committee are added.

In closing, we thank the Subcommittees for this opportunity to present the CRIS proposal and we will be pleased to address any questions or comments you may have.

Senator ROCKEFELLER. Thank you, Mr. Stair.

[The prepared statement of Mr. Stair appears in the appendix.]

Senator ROCKEFELLER. Mr. Schanes.

STATEMENT OF STEVEN SCHANES, WORKER EQUITY VOLUNTEER, AMERICAN ASSOCIATION OF RETIRED PERSONS, SAN DIEGO, CA, ACCOMPANIED BY DAVID CERTNER, LEGISLATIVE REPRESENTATIVE

Mr. SCHANES. Thank you very much, Senator. My name is Steven Schanes and I am pleased to represent AARP today to discuss the issue of employer-provided retiree health benefits. With me is David Certner, a member of the AARP legislative staff. We have submitted a full statement to you, Senator. My added remarks today are to emphasize AARP's special concern on behalf of retiree and active members of pension funds.

First, my background. I was the first executive director of the Pension Benefit Guaranty Corp.; I am now President of a consulting firm. I will focus my remarks today on the use of pension fund reserves to finance retiree health benefits. The AARP generally opposes such proposals since they merely sacrifice long-term pension funding objectives to meet current retiree health needs.

In order to meet the long-term promise of defined benefit pension plans by actuarial practice companies are generally required to prefund pension benefits in the early years. In essence, all plans that are funded on an actuarially sound basis have more assets than are currently needed. While many refer to these plans as overfunded, in most cases, these so-called surplus assets are needed to meet future promised pension obligations.

Proposals to strip this money to meet retiree health liabilities, whether by asset transfers or plan terminations, threaten to undermine the stability of pension plans. Shifting pension assets to meet other needs, even worthy needs such as retiree health benefits not only undermines the pension promise but it frustrates the very purpose for which a tax subsidy was originally intended.

For this reason, the Committee should enact greater restrictions on access to pension funds, particularly to deter the practice of pension terminations for reversions, whether or not an asset transfer proposal is considered. Until the original pension promise can be fully secured, including adequate protections for both workers and retirees, the Association would oppose any transfer of pension assets for other purposes.

In order to fully secure the pension promise, funding levels should be based on the projected benefit obligations of a plan, not a plan's current obligations. Reference to current liability alone does little to assure the long-term nature of a pension promise.

In addition, a buffer of assets above projected benefit obligations should be maintained to ensure against investment downturn.

Currently proposed legislation, S. 685—the Employee Pension Protection Act—establishes the type of framework for pension benefit security. While this is not the only alternative, AARP supports this legislation. This approach is consistent with what AARP believes is necessary to secure the pension promise, whether in plan terminations or in plan asset transfers. Other proposals, based on arbitrary levels above current liability, do not fully account for long-term funding needs.

The Association, therefore, supports planned specific funding levels, based on the ongoing funding needs of the individual plan, rather than reference to arbitrary levels based on current liability.

Current law, however, contains an arbitrary funding limit. The 150 percent full funding limit, which is inadequate for proper funding in most instances, allowing access to pension funds below this level would not only provide less benefit security but it would also allow employers to game the tax system. In fact, a new funding loophole would be established, thus undoing the tightening funding requirements of recent legislation and possibly endangering PBGC.

Recently, however, two House Committees acted to permit pension transfers above the funding limit for retiree health. If pension assets are used to pay for retiree health protection benefits, certain protections are essential. It would be bad policy to transfer money from a highly regulated, guaranteed pension system with basic employee protections to a nonregulated, unprotected, ill-defined retiree health promise.

Specifically, in the event pension plan asset transfers are permitted, this Committee should prohibit access to planned funds for other purposes, including upon plan termination; permit transfers only on behalf of retirees who are members of the pension plan; prohibit any reversion of transferred funds; immediately vest all participants in their pension; give proper and timely notice to all affected parties; and guarantee retiree health benefit levels existing at the time of the transfer.

In addition, AARP urges this Committee to take a broader look at the long-term problems posed by retiree health benefits. The Association supports efforts to establish employer-incentives for prefunding, coupled with appropriate employee standards and protections. AARP looks forward to continued work with this Committee on these and other important retirement income securities.

I would be happy to answer any questions of the Chairman.

[The prepared statement of Mr. Schanes appears in the appendix.]

Senator ROCKEFELLER. Thank you both very, very much. I will put forth some questions.

Mr. Stair, I might start with you. Do you believe that additional tax subsidies to employers for prefunding retiree health benefits are necessary in order to adequately ensure continuation of retiree health plans?

Mr. STAIR. I do know, sir, that absent such incentives, employers will be unable to help the Congress in solving the retiree health care problem. Absent those types of incentives, employers will be

unable to help the Congress solve this issue. That is why these incentives are necessary—absolutely essential.

Senator ROCKEFELLER. Can you explain what businesses must do to comply with the new FASB rules?

Mr. STAIR. No, sir. The FASB rules will go into effect—not yet, but they will go into effect about 1992 and then I believe there are some further impacts beyond that in 1994. Employers will be required to—I am not an accounting expert so I have to caveat everything I say by that statement—employers will be required to show liabilities on their balance sheets to reflect their commitments for these retiree health care benefits. Costs for such benefits are also expected to increase quite substantially as reported on financial statements.

Senator ROCKEFELLER. Okay. To the best of your knowledge, what will be the benefits of the CRIS proposal with respect to a company's financial statements in light of the FASB proposal?

Mr. STAIR. That is unclear. Under some sets of scenarios and some sets of analyses that we have witnessed and seen and reviewed, there is no impact. Under others, there are some benefits, depending on the corporations particular sets of circumstances I believe is the difference. For some companies there will be no impact, for others there may be some benefit to the CRIS proposal.

Senator ROCKEFELLER. The Ways and Means Committee Bill imposes a number of requirements before excess defined benefit plan assets may be transferred to retiree health accounts. For example, the transfer may occur only once; retirement plan participants must be vested and annuitized; and the plan must be funded up to at least 140 percent of the current liability.

Would these requirements discourage businesses from making these transfers or are there requirements appropriate in your view?

Mr. STAIR. The requirements are entirely inappropriate in my view and they provide, in fact, disincentives to employers to make such transfers, rather than incentives to employers to make such transfers. It is our view that no CRIS company would make such a transfer were the Ways and Means mark to become fact.

Senator ROCKEFELLER. What is in the CRIS proposal for retirees?

Mr. STAIR. Benefit security. It is very simple. Right now no assets are dedicated or set aside to provide for those benefits during retirement. Under the CRIS proposal, you would create a pool of assets dedicated to that purpose.

Senator ROCKEFELLER. All right. What are the risks in the CRIS proposal for pension plan participants and the Pension Benefit Guarantee Corporation?

Mr. STAIR. None.

Senator ROCKEFELLER. Describe the retirees whose health benefits would be funded under the CRIS proposal. Would they represent all former employees or certain classes of former employees? What guarantees are there that the transferred funds will actually be used to provide benefits to pension plan participants?

Mr. STAIR. Okay. The first part of the question is, what group of employees are we covering and what group of retirees are we covering. There the CRIS proposal states that what we would do is cover the same group of retirees that are presently covered by the

pension plan from which the assets were withdrawn or transferred and who are receiving health benefits. So it would be that same group of retirees.

The guarantees—the CRIS proposal states that the benefits, or the assets transferred, would be dedicated to the exclusive benefit of those retirees and would be used only for the purpose of paying retiree health care benefits.

Senator ROCKEFELLER. I thank you.

Mr. Schanes.

Mr. SCHANES. Yes, sir.

Senator ROCKEFELLER. Do you believe business by and large are funding their pensions only to the extent they believe they need to meet future obligations or are they seeing the funds as a place to put excess cash?

Mr. SCHANES. No, I think businesses are funding their obligations as the actuary certifies and in accordance with statute. The actuary tells them what should be—we are talking about defined benefit plan for a moment. Actuaries tells them what is required by virtue of their liabilities and that is what they set aside, subject to certain limitations of statute.

Senator ROCKEFELLER. All right. One final question. In your view, what are the risks in the CRIS proposal for pension plan participants?

Mr. SCHANES. Considerable, Mr. Rockefeller.

First of all, the current liability of pension plans is not a true measure of a liability of a pension plan. The liability of a pension plan goes through its long-term obligations. By virtue of the fact that defined benefit plans largely are based—the promise is based on long-term service and future salaries—salaries at termination. Any time during the employee's life career he is not at that point of final salary. The actuary is certifying the contributions based on that anticipation in the future.

So you have an excess of funds currently, at all times, in a normal pension plan. To use that current liability figure—what the benefits are today—as a measure against the assets is an inappropriate test, but it is what is used right now. To the extent that you say that some sum above that is a surplus is a very dangerous thing. The market could change tomorrow. It is not a true measure of the pension fund's liability and it is an inappropriate use of the assets. So that if you were then to say we would draw down a certain number, or a certain amount of those assets, above some arbitrary figure, you are then imperiling the retirement fund members by virtue of that decision. You are providing some degree of benefits payment for obligations the corporation already has for retiree health, but you, in effect, are putting the retirement fund at somewhat of a risk.

Senator ROCKEFELLER. Mr. Stair, you would not agree with that?

Mr. STAIR. That is correct. Thank you.

I believe that at the hearings held in front of the House Ways and Means Subcommittee on Oversight just last month the Department of Labor indicated at those hearings that an asset cushion of 125 percent of current liabilities—they believe is adequate protection for existing plan obligations. We certainly agree with that.

Senator ROCKEFELLER. And your response?

Mr. SCHANES. Twenty-five percent is wholly inadequate. I merely look at what happened to the stock market on one given day and I see what happened to asset values.

Senator ROCKEFELLER. Mr. Stair?

Mr. STAIR. In crafting the CRIS proposal, and in trying to establish a limit on the amount of assets that could be transferred, we imposed two limits. The first limit is the present value of the health care obligation that you are transferring to a fund. The second limit is to provide that at least some cushion amount should remain within the pension trust fund. In arriving at the 125 percent we drew upon some existing proposals along these lines as being something that is already lying around, already being talked about, already being used.

In our analysis of the CRIS proposal in terms of the revenue impact, we discovered interestingly in my view that the limiting factor was not 125 percent of current liabilities. The limiting factor in these transfers was actually the amount of the health care obligation that you are prefunding.

In other words, the amount of assets that could be transferred was limited by the amount of the health care obligation that you were funding toward, not 125 percent of your current liabilities. Actually, we still had a whole lot of money left over long before we even got down to 125 percent of current liabilities.

I believe that the CRIS companies were fairly typical in that regard. We commissioned Price Waterhouse to do a study on the revenue impact. This was one of their findings. I believe that we had to set a limit somewhere—125 percent seemed to be a fairly comfortable place, particularly in light of the fact that the Department of Labor was supporting it. And also particularly in light of the fact that it did not really seem to be a big impact or a big factor in the amount of the revenues that are being raised by the proposal.

Senator ROCKEFELLER. Final comment, Dr. Schanes?

Mr. SCHANES. Sir, I have not seen the CRIS study that was commissioned for CRIS. So I do not understand limitation on the retiree health side, so I cannot comment on the point being raised here.

I am very concerned in terms of an arbitrary figure of 25 percent, both in terms of its effect and the downturn on PBGC, for example, and also in terms of the protection for retirees and pension members. This is an arbitrary figure which might apply in certain instances where you have an ongoing comfortably situated business and might not very well apply in another. A blanket arbitrary rule is very dangerous. The industries change, businesses change, conditions change. A 25 percent buffer from the actuarial consulting standpoint is awfully close.

Senator ROCKEFELLER. Gentlemen, I thank all of you. Mr. Certner, you also. I appreciate your coming before this hearing and this hearing is adjourned.

Senator DURENBERGER. Mr. Chairman.

Senator ROCKEFELLER. Oh, I am sorry. Senator Durenberger, I did not see you.

Senator DURENBERGER. Thank you very much, Mr. Chairman.

I hate to keep you but I am going to have to stay. Mr. Stair, do you have a list of the members of CRIS?

Mr. STAIR. Yes, sir; I do.

Senator DURENBERGER. Could you submit that to us?

Mr. STAIR. I sure will.

Senator DURENBERGER. You probably do not want to have this, but I guess it might be helpful for illustrative purposes, if in addition to identifying the names of the companies involved, if we get some indication of the extent of the retiree health liability of those companies I know a lot of that is estimated. Would that be possible?

Mr. STAIR. I do not see why not, sir. That information has already been shared with the Joint Tax Committee and their evaluation of the CRIS proposal and we would be delighted to give it to you.

Senator DURENBERGER. And then is the same true of the so-called excess assets that they retain in their pension accounts, that same kind of list would be available?

Mr. STAIR. Yes, sir; that is all part of it. Right.

Senator DURENBERGER. Great. In estimating that your proposal will raise revenue for the Treasury, could you tell me how you anticipate these companies will use the funds that are not expended for retiree health? Do you anticipate these funds will be available for other deductible expenses and if so, to what degree would that diminish the anticipated revenue gain?

Mr. STAIR. The question that you are asking is one which I guess leaves my realm of expertise and capabilities to deal with. It is a question that has come up again and again as we have talked about the revenue impact of the CRIS proposal and what that might be.

The study that we commissioned, performed by Price Waterhouse, was based on the assumption that all of the companies that could would transfer all of the money that they could and raise about $6–7 billion over the 5-year period. There was no assumption made as to what the companies might do with that money that might otherwise be deductible.

Our statement states that regardless of what a company might do with it, it would result in stimulation of investment and increased U.S. competitiveness.

Senator DURENBERGER. Since both the Chair, right now, and I are respectively the Chair and one of the Vice-Chairs of the Bi-Partisan Commission on Comprehensive Health Care—and obviously this is an issue that we are going to have to deal with as well—to the degree that with further study and whatever is underway you can elaborate on that particular request for information, it would be helpful to us over the next couple of months, or maybe the next more than couple of months, depending on what happens tomorrow morning.

Mr. STAIR. We would be delighted to assist you in any way we can.

Senator DURENBERGER. Great.

Under one variation of your proposal you suggest employers be allowed three transfers from their excess assets within a 10-year period for the purpose of advance funding of health benefits for current retirees. Can you tell me what guarantees current employees and retirees have that the companies—like the companies in

your Coalition will have—that the companies will have the resources to provide the retiree health benefits that you are currently committed to.

Mr. STAIR. There are no guarantees as to the future. In fact, nobody knows the future. We all witnessed companies who are experiencing very bad times and none of those companies would have forecasted them 5 years ago. So our view on that is, there are no guarantees. There is no commitment as to the future payment of these benefits. This is a way of solving that problem.

Senator DURENBERGER. Do your current employees and retirees have vested retiree health benefits?

Mr. STAIR. No, sir; not under the terms of the plan. In fact, the plan states that the company can change, terminate and withdraw those benefits at any time. Now as a practical matter there may be some legal issues around that question which would be resolved, and resolvable only in a court room. But our position is that there is no vesting of those benefits.

Senator DURENBERGER. Is that true for all of the companies involved?

Mr. STAIR. Yes, sir. It is quite common not to have vesting.

Senator DURENBERGER. Right. To the extent that there might be legal or other issues related to that, it might be helpful to us if you can elaborate on the response to that question as well.

Are there minimum participation standards for participating in retiree health benefits or health plans? For example, maximum age and service requirements.

Mr. STAIR. Not beyond those that would potentially be effect under Section 89 and other existing laws around welfare benefit plans. We have not chosen to add any such requirements because those requirements are already in place.

Senator DURENBERGER. Are retiree health benefits portable?

Mr. STAIR. Portable? Well, under the current situation, retiree benefits are not portable. And under the CRIS proposal, we would only be talking about funding for benefits for retirees, not for active employees. So we have chosen specifically to deal with existing retirees, not for people that are actively employed in a work force and for whom portability is an issue.

Senator DURENBERGER. What, if any, standards for guaranteeing a retiree health benefit do you think this Committee should consider imposing in exchange for allowing companies to prefund retiree health liabilities or do you have a list you would like to submit?

Mr. STAIR. We have seen some ideas on what sorts of benefit securities are necessary—such as in the House Ways and Means mark requiring vesting and annuitization. We believe that those requirements are onerous, sufficiently onerous as to drive companies away in mass from such transfers. What we need here are some incentives to attract employers to the notion of doing this, to persuade employers to do it.

I think the question should not be: What are employers willing to give up? I think the question should be: What is Congress and what can Congress do to provide those incentives to help solve this problem?

Senator DURENBERGER. Let me just finish on that point, if I may, Mr. Chairman. I think that was sort of appropriately stated. I need

to clarify one thing with regard to what employers or employees are willing to give up for my own benefit, as I approach this issue.

I know some of the companies that are in the Coalition and I know that some of them still provide first dollar—in fact, quite a number of them still provide first dollar coverage on health benefits. I do not want to launch into my usual speech about how much that already costs the government. Not the government, the taxpayers of this country, particularly little employers and people like that who cannot afford it, to provide AT&T and other companies like that with huge health plan benefits, some substantial part of which is at the expense of the taxpayers.

Can you give me any encouragement on behalf of the Coalition members that if we were able to persuade not only Senator Metzenbaum, but others of our colleagues, that this is a great idea, that is letting you use the extra assets for health benefits—and I really support it; I mean, I strongly support you in this effort—that these same companies, to the degree that their employees will benefit from this change in policy would also support some limits on the tax deductible nature of health plan benefit? Do you know what I am talking about or do I need to explain?

Mr. STAIR. No, keep going.

Senator DURENBERGER. The proposal from the Reagan Administration simply was that the tax-free nature of the premium contribution by the employer be limited at some point. I think their original recommendation was $250 a month for a family.

Mr. STAIR. I understand. Yes, right. Taxing the benefit or the value of the benefit or putting a floor or a cap or—you know, there have been a couple of different approaches to that.

Is the question: Would we be willing to accept such taxes in exchange for the free-funding issue?

Senator DURENBERGER. Right.

Mr. STAIR. CRIS has not taken a position on that notion. In fact, we have not been asked the question before now. If you would like, we would be happy to go back and address that. I can tell you my personal feeling on it is that I believe that taxation of these benefits is inevitable. There have also been strong arguments that unlike pension benefits when these payments come out of a retiree health care trust they are not taxed to the beneficiaries, unlike pension benefits which are taxable income to beneficiaries; and therefore, providing a sort of tax haven around these health care assets might be providing more of a tax incentive than is necessary.

That is another point of view. But I continue to hold to the view that what we need to do is exactly that—provide additional tax incentives to employers to help solve this problem. Absent those types of incentives, employers will not step up to the table.

Senator DURENBERGER. Well, that is why my first question was, I would like to know who is in this Coalition. Because before I buy that conclusion for some of the companies I know are in that Coalition. I think it would really be helpful if you take this question as a fairly serious effort on at least one of our parts to get to the end that you want to get to and find some way to combine both the incentives that you are looking for with some of the responsibility on

behalf of the employers and the employees that might help to facilitate this sort of change.

I have no more questions. Thank you very much.

Senator DURENBERGER. Thank you, gentlemen.

I apologize to Senator Durenberger.

Thank you very much. The hearing is adjourned.

[Whereupon, the hearing was adjourned at 5:43 p.m.]

APPENDIX

ALPHABETICAL LISTING AND MATERIAL SUBMITTED

SUBMITTED BY SENATOR MAX BAUCUS

PRESENT LAW AND PROPOSALS RELATING TO EMPLOYEE STOCK OWNERSHIP PLANS (INCLUDING S. 1303 AND S. 1171)

(Prepared by the Staff of the Joint Committee on Taxation, JCX-34-89)

INTRODUCTION

The subcommittees on Taxation and Debt Management and Private Retirement Plans and Oversight of the Internal Revenue Service of the Senate Committee on Finance have scheduled a joint hearing on July 19, 1989, on employee stock ownership plans (ESOPs).

This document,[1] prepared by the staff of the Joint committee on Taxation, provides a description of present-law tax rules and proposals relating to employee stock ownership plans (ESOPs), including S. 1303 (introduced by Senator Bentsen), S. 1171 (introduced by Senator Dole), and proposals before the House Committee on Ways and Means.

DESCRIPTION OF PROPOSALS RELATING TO EMPLOYEE STOCK OWNERSHIP PLANS

A. PRESENT LAW

Leveraged ESOPs

Present law generally prohibits loans between a qualified plan and a disqualified person (sec. 4975). An exception to this rule is provided in the case of an employee stock ownership plan (ESOP).

If employer securities are acquired by an ESOP with loan proceeds, the ESOP is referred to as a leveraged ESOP. The ESOP may borrow directly from a financial institution (typically with a guarantee from the employer), or the employer may borrow from a financial institution and in turn lend the funds to the ESOP which then uses them to acquire employer securities. The employer securities are typically pledged as security for the loan. The employer makes contributions to the ESOP which are then used to repay the acquisition loan. Shares that are acquired with an acquisition loan are allocated to the accounts of ESOP participants as the loan is repaid.

In general, the type of employer securities that may be held by an ESOP are (1) common stock of the employer that is readily tradable on an established securities market, or (2) if there is no such common stock, common stock issued by the employer having a combination of voting power and dividend rights at least equal to that class of common having the greatest voting power and that class of common having the greatest dividend power. Noncallable preferred stock is treated as employer securities if such stock is convertible into stock that meets the requirements of (1) or (2), whichever is applicable.

ESOPs are required to pass through to plan participants certain voting rights with respect to employer securities. In the employer has a registration-type class of securities, the ESOP is required to permit each participant to direct the plan as to

---

[1] This document may be cited as follows: Joint Committee on Taxation, Present Law and Proposals Relating to Employee Stock Ownership Plans (including S. 1303 and S. 1171 (JCX-34-89), July 19, 1989.

the manner in which employer securities allocated to the account of the participant are entitled to vote. If the employer does not have a registration-type class of securities, the plan is required to permit each participant to direct the plan as to the manner in which voting rights are to be exercised only with respect to certain enumerated corporate issues, such as the approval or disapproval of any corporate merger or consolidation, recapitalization, reclassification, and similar transactions as prescribed by the Secretary.

Interest exclusion for ESOP loans

A bank, an insurance company, a corporation actively engaged in the business of lending money, or a regulated investment company may exclude from gross income 50 percent of the interest received with respect to a "securities acquisition loan" used to acquire employer securities for an ESOP (sec. 133). A "securities acquisition loan" is generally defined as (1) a loan to a corporation or to an ESOP to the extent that the proceeds are used to acquire employer securities for the ESOP, or (2) a loan to a corporation to the extent that the corporation transfers an equivalent amount of employer securities to the ESOP and such securities are allocable to accounts of ESOP participants within I year of the date of the loan (an "immediate allocation loan").

B. DESCRIPTION OF PROPOSALS

1. S. 1303—Senator Bentsen [2]

Limitations on partial interest exclusion

The bill would limit the circumstances in which the partial interest exclusion is available. In general, under the bill, the partial interest exclusion would not apply to a securities acquisition loan unless (1) the ESOP owns at least 30 percent of each class of outstanding stock of the corporation issuing the employer securities or 30 percent of the total value of all outstanding stock of the corporation immediately after the acquisition of the securities acquired with the loan, (2) the term of the loan does not exceed 15 years, and (3) each participant is entitled to direct the plan as to the manner in which shares allocated to the participant's account are to be voted. These requirements would apply to transfers of stock with respect to an immediate allocation loan as well as other types of securities acquisition loans.

The 30-percent requirement is designed to ensure that the ESOP holds a substantial share of the company's stock. After the sale of the stock to the ESOP, the ESOP would generally be required to hold the employer securities for at least 3 years. A 10-percent excise tax would be imposed on the employer sponsoring the ESOP on the amount realized upon disposition if, within 3 years after the acquisition of the employer securities with a loan to which section 133 applies, the ESOP disposes of employer securities and the total number of employer securities held by the ESOP is less than the total number held after the acquisition or the value of the employer securities held by the plan after the disposition is less than 30 percent of the value of the outstanding securities. The excise tax would not apply to certain distributions, such as distributions to plan participants and distributions with respect to certain corporate reorganizations.

A 10-percent excise tax would also be imposed on the amount realized upon disposition if the ESOP disposes of the employer securities before the securities are allocated to accounts of participants and the proceeds from such disposition are not so allocated.

These excise tax rules are similar to the rules that apply to a sale of stock to an ESOP if the seller elects to defer recognition of gain on the sale (sec. 1042) or claims an estate tax deduction with respect to the sale (sec. 2057).

The bill would provide that, with respect to shares acquired with a section 133 loan, plan participants must be entitled to direct the plan as to the voting of shares allocated to his or her account on all issues. This requirement would apply regardless of whether the employer has a registration-type class of securities. In addition, under the bill, if the shares are convertible preferred stock, the participants must be entitled to direct the voting of such stock as if the preferred stock had the voting rights of the common stock of the employer having the greatest voting power.

Effective date

The bill would generally be effective with respect to loans made after June 6, 1989. However, the bill would not apply to loans made after June 6, 1989, to refinance loans made on or before such date (or to refinance loans described in the next

[2] S. 1303 was introduced by Senator Bentsen on July 12, 1989.

paragraph), if (1) such refinancing loan meets the requirements of section 133 (as in effect before the amendments made by the bill), and (2) the outstanding principal amount of the loan is not increased.

In addition, the bill would not apply to any loan (1) made pursuant to a binding written commitment in effect on June 6, 1989, and at all times thereafter before the loan is made, or (2) the proceeds of which are use to acquire employer securities pursuant to a written binding contract (or tender offer registered with the Securities and Exchange Commission) in effect on June 6, 1989, and at all times thereafter before such securities are acquired.

With respect to the grandfather rule for certain loans made after June 6, 1989, the legislative history would provide that the existence of a written binding loan commitment can be demonstrated, for example, by a combination of documentation by the lender, written communications by the borrower or the borrower's agent (e.g., an investment banker or a broker), and documentation of the borrower showing that the loan was approved by the lender and that the offer to make the loan was received by the borrower. Such documentation would have to include the principal terms of the loan, such as the principal amount, interest rate or spread, and maturity of the loan.

2. S. 1171—Senator Dole [3]

Repeal of partial interest exclusion

The bill would repeal the partial interest exclusion under section 133 for ESOP loans.

Effective date

The bill would generally be effective for loans made after June 6, 1989, including loans made to refinance loans made on or before such date. However, the repeal would not apply to any loan (1) made pursuant to a written binding commitment in effect on June 6, 1989, and at all times thereafter, or in connection with a tender offer, exchange offer or registration statement filed with the Securities and Exchange Commission on or before June 6, 1989, to the extent that the ESOP transaction is described in such documents, (2) used to acquire employer securities which were purchased by the employer on or before June 6, 1989, pursuant to a corporate resolution adopted or before June 6, 1989, providing for the sale of the employers securities to an ESOP, (3) if a public announcement of the ESOP plan was made by the employer on or before June 6, 1989, setting forth the amount or value of the employer securities to be contributed to the ESOP, or (4) the employer reached an agreement in principle with its lenders, which agreement was evidenced by a written confirmation on or before June 6, 1989, setting forth the principal amount, interest rate or spread, and maturity of the loan.

3. House Ways and Means Committee Action [4]

Limitation on partial interest exclusion

The House Committee on Ways and Means agreed to limit the availability of the partial interest exclusion to situations in which the ESOP owns, immediately after the sale, at least 30 percent of each class of outstanding stock of the employer or 30 percent of the total value of all outstanding stock of the employer. The interest exclusion ceases to apply if the percentage ownership of the employer by the ESOP falls below 30 percent at any time. In addition, the Ways and Means Committee agreed to repeal Revenue Ruling 89-76, relating to publicly traded ESOP debt.

The provision would generally be effective for loans made after July 10, 1989, including loans made after such date to refinance loans made on or before such date. However, the provision would not apply to any loan pursuant to a written binding commitment in effect on July 10, 1989, and at all times thereafter before such loan is made. This exception would apply only to the extent that the proceeds of such loan are used to acquire employer securities pursuant to a written binding contract (or a tender offer registered with the Securities and Exchange Commission) in effect on July 10, 1989, and at all times thereafter before such securities are acquired.

Further, the provision would not apply to loans made to refinance loans made on or before July 10, 1989, or to loans made to refinance loans made after such date and that are grandfathered under the rules described above if (1) the outstanding principal of the loan is not increased by the refinancing, (2) the original lender was

---

[3] S. 1171 was introduced by Senator Dole on June 13, 1989.

[4] This is a summary description of action taken on July 12, 1989, by the House Committee on Ways and Means in its markup of revenue reconciliation provisions.

a lender that qualifies for the interest exclusion under section 133, and (3) the term of the loan is not extended, or the total period of the loan (including the term of the original loan and the refinanced loan) is not more than 7 years.

As under S. 1303, the legislative history would provide that the existence of a written binding loan commitment can be demonstrated, for example, by a combination of documentation by the lender, written communications by the borrower or the borrower's agent (e.g., an investment banker or a broker), and documentation of the borrower showing that the loan was approved by the lender and that the offer to make the loan was received by the borrower. Such documentation would have to include the principal terms of the loan, such as the principal amount, interest rate or spread, and maturity of the loan.

Other ESOP provisions

In addition to the action taken with respect to the partial interest exclusion, the Ways and Means Committee also agreed to take the following action relating to ESOPs: (1) provide that deferral of recognition of gain on the sale of employer securities to an ESOP would be available only if the taxpayer held the securities for 3 years before the sale to the ESOP; (2) repeal the deduction for dividends paid on employer securities held by an ESOP (sec. 404(k)) unless the ESOP holds at least 30 percent of the stock of the employer; (3) repeal the 50-percent estate tax deduction in the case of certain sales of employer securities to an ESOP (sec. 2057); (4) repeal a provision relating to the assumption of estate tax liability by an ESOP for employer securities acquired by the ESOP (sec. 2210); (5) repeal special limits on contributions to certain ESOPs (sec. 415(c)(6)); and (6) repeal section 382(l)(3)(C), which provides that stock acquired by an ESOP is not taken into account in determining whether an ownership change has occurred for purposes of determining applicable limits on net operating loss carryforwards following a change of ownership.

Present Law and Proposals Relating to Employer-Provided Retiree Health Insurance

(Prepared by the Staff of the Joint Committee on Taxation, July 19, 1989, JCX-35-89)

INTRODUCTION

The Subcommittees on Taxation and Debt Management and Private Retirement Plans and Oversight of the Internal Revenue Service of the Senate Committee on Finance have scheduled a joint hearing on July 19, 1989, on employer-provided retiree health insurance issues.

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of present-law tax rules and proposals, relating to employer-provided retiree health insurance. The first part describes present-law tax rules; the second part is an analysis of tax incentives for prefunding retiree health liabilities; and the third part is a description of certain proposals currently under consideration by Congress, including S. 812 (introduced by Senator Pryor) and proposals before the House Committee on Ways and Means.

I. Present Law

A. IN GENERAL

Under present law, employer-provided post-retirement medical benefits are generally excludable from the gross income of a plan participant or beneficiary. Present law provides two tax-favored funding arrangements to accumulate assets to provide post-retirement medical benefits separately from other retirement benefits. First, separate accounts in certain qualified retirement plans may be used to provide post-retirement medical benefits (sec. 401(h)).

Although assets allocated to a post-retirement medical benefit account are accorded tax treatment similar to that provided for other assets held by a qualified retirement plan, the benefits provided under post-retirement medical accounts are required to be incidental to the retirement benefits provided by the plan. The inciden-

---

[1] This document may be cited as follows: Joint Committee on Taxation, *Present Law and Proposals Relating to Employer-Provided Retiree Health Insurance* (JCX-35-89), July 19, 1989. See also Joint Committee pamphlet, *Present Law and Issues Relating to Employer-Provided Retiree Health Insurance* (JCS-15-89), June 12, 1989.

tal benefit requirement may preclude funding the entire post-retirement medical benefit through a separate account in a qualified plan.

The second funding medium that can be used to prefund post-retirement medical benefits is a welfare benefit fund (secs. 419 and 419A). Welfare benefit funds generally are not subject to the contribution limits applicable to the separate accounts under a qualified plan, but are subject to separate limits on the deductibility of employee contributions. In addition, medical benefits provided through a welfare benefit fund are excluded from the employee's gross income unless the benefits are provided on a discriminatory basis. However, income set aside in a welfare benefit fund to provide post-retirement medical benefits generally is subject to income tax.

Although advance funding of post-retirement medical benefits is not accorded tax treatment comparable to that provided for retirement benefits under qualified retirement plans, they also are not subject to the same minimum standards applicable to retirement plans.

In addition to the two methods described above for funding post-retirement medical benefits, plan participants may, of course, use distributions from qualified plans to purchase post-retirement medical benefits. The use of such retirement plan distributions to purchase post-retirement medical benefits is equivalent to the purchase of such benefits on an after-tax basis from other income.

Many proposals in this area involve the funding of defined benefit pension plans and the use of the assets of such plans that are in excess of those necessary to satisfy all plan liabilities ("excess assets"). Subject to certain limitations, an employer may under present law make deductible contributions to a defined benefit pension plan up to the full funding limitation. The full funding limitation is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan or (b) 150 percent of the plan's current liability, over (2) the lesser of (a) the fair market value of the plan's assets, or (b) the actuarial value of the plan's assets.

Under present law, excess assets may be returned to the employer at the time the plan terminates (sec. 401(a)(2)). The employer who receives a reversion of such assets must include the amount in its gross income. The amount is also subject to a 15-percent excise tax (sec. 4980).

Under present law, excess assets in a defined benefit pension plan may not be used on a tax-favored basis to fund a section 401(h) account or a VEBA.

B. EMPLOYEE TAX TREATMENT OF POST-RETIREMENT MEDICAL BENEFITS

The value of employer-provided coverage under a health plan that provides post-retirement medical benefits to former employees, their spouses, or dependents is generally excludable from gross income (sec. 106). The exclusion applies whether the coverage is provided by insurance or otherwise. Thus, for example, the exclusion applies if the employer pays insurance premiums for post-retirement medical coverage, or provides post-retirement medical benefits through a trust.

Gross income generally does not include amounts that are paid directly or indirectly to a former employee to reimburse him or her for expenses incurred for the medical care of the former employee or his or her spouse or dependents. The exclusion applies whether the benefits are paid for by employer contributions (sec. 105) or employee contributions (sec. 104)

The Tax Reform Act of 1986 added specific nondiscrimination rules that apply to the value of the employer-provided coverage under all health plans (sec. 89). If a health plan does not satisfy these nondiscrimination rules, then the highly compensated employees or highly compensated former employees participating in the plan are required to include in gross income the excess benefit received under the plan. The excess benefit is, in general, the excess of the value of the employer-provided benefit over the maximum employer-provided benefit that could be provided if the plan were nondiscriminatory. For this purpose, the employer-provided benefit is the value of the health coverage provided by the employer (not the amount of reimbursements received under the plan).

In addition, gross income includes an employee's or former employee's total employer-provided benefit unless the plan meets certain qualification requirements (sec. 89(k)), for example, a requirement that the plan be in writing, and that the employee's rights under the plan are legally enforceable. For this purpose, the employer-provided benefit is the amount of reimbursements received, rather than [2] the value of the coverage (e.g., the insurance premiums).

---

[2] There are currently several bills pending before Congress that would delay or repeal section 89, including the qualification requirements of section 89(k).

C. EMPLOYER TAX TREATMENT OF CONTRIBUTIONS FOR POST-RETIREMENT MEDICAL BENEFITS

Current benefits

Post-retirement medical benefits that are not funded through a qualified retirement plan or a welfare benefit fund are generally treated for employer deduction purposes the same as deferred compensation that is provided under a nonqualified deferred compensation plan (sec. 404). Nonqualified deferred compensation is deductible by the employer for the taxable year in which the compensation is includable in the income of the employee, or would be includable in the gross ii come of the employee without regard to any exclusion of the benefit from the employee's income. Thus, employer contributions to provide post-retirement medical benefits are deductible when the coverage is provided to the former employee.

The deduction rules for post-retirement medical benefits provided through a qualified plan or a welfare benefit fund are discussed below.

Prefunding of future benefits

In general

Under present law, tax-favored prefunding of post-retirement medical benefits can be accomplished in two basic ways: (1) through a tax-qualified pension plan by establishing a separate account under a pension or annuity plan that satisfies certain requirements (sec. 401(h)), or (2) through a welfare benefit fund (secs. 419 and 419(A)). In addition, distributions from qualified plans may be used by the plan participant to acquire post-retirement medical benefits.

Separate account under qualified pension's

Under the separate account method of prefunding post-retirement medical benefits, a tax-qualified pension or annuity plan may provide for the payment of sickness, accident, hospitalization, and medical expenses for retired employees, their spouses, and their dependents provided certain additional qualification requirements are met with respect to the post-retirement medical benefits (sec. 401(h)). First, the medical benefits, when added to any life insurance protection provided under the plan, are required to be incidental to the retirement benefits provided by the plan. Under Treasury regulations, the medical benefits are considered incidental or subordinate to the retirement benefits if, at all times, the aggregate of employer contributions (made after the date on which the plan first includes such medical benefits) to provide such medical benefits and any life insurance protection does not exceed 25 percent of the aggregate contributions made after such date, other than contributions to fund past service credits. Additional medical benefits and life insurance protection may be provided with employee contributions.

The second requirement is that a separate account is to be maintained with respect to contributions to fund such medical benefits. This separate accounting generally is determined on an aggregate, rather than a per-participant basis, and is solely for recordkeeping purposes.

The rationale for requiring that the post-retirement medical benefits funded in this manner be subordinate and be provided under a separate account is that such benefits generally are not subject to the minimum standards, such as vesting, funding, and accrual rules, generally applicable to qualified retirement plans. In addition, such benefits are not subject to any Federal guaranty, such as the guaranty provided by the Pension Benefit Guaranty Corporation with respect to pension benefits. Thus, Congress considered it important not only to limit the tax-favored treatment of such benefits but also to ensure that these relatively unrestricted benefits did not reduce the funds contributed to provide nonmedical retirement benefits pursuant to the minimum standards.

The third requirement is that the employer's contributions to a separate account are to be reasonable and ascertainable. Fourth, the plan is required to preclude the use of amounts in the separate account for any other purpose at any time prior to the satisfaction of all liabilities with respect to the post-retirement medical benefits. Fifth, upon the satisfaction of all plan liabilities to provide post-retirement medical benefits, the remaining assets in the separate account are to revert to the employer and cannot be distributed to the retired employees. Similarly, if an individuals right to medical benefits is forfeited, the forfeiture is to be applied to reduce the employer's future contributions for post-retirement medical benefits.

The final requirement is that, in the case of an employee who is a "key employee" (as defined in sec. 416), a separate account is to be established and maintained on a per-participant basis, and benefits provided to such employee (and his or her spouse and dependents) are to be payable only from the separate account. This requirement

applies only to benefits attributable to plan years beginning after March 31, 1984, for which the employee is a key employee. Also, contributions to the separate account are considered annual additions to a defined contribution plan for purposes of the limits on contributions and benefits applicable to retirement plans (sec. 415), except that the 25 percent of compensation limit (sec. 415(c)(1)(B)) does not apply.

If the requirements with respect to post-retirement medical benefits are met, the income earned in the separate account is not taxable. Also, employer contributions to fund these benefits are deductible under the general rules relating to the timing of deductions for contributions to qualified retirement plans. The deduction for such contributions is not taken into account in determining the amount deductible with respect to contributions for retirement benefits. The amount deductible may not exceed the total cost of providing the medical benefits, determined An accordance with any generally accepted actuarial method that is reasonable in view of the provisions and coverage of the plan and any other relevant considerations. In addition, the amount deductible for any taxable year may not exceed the greater of (1) an amount determined by allocating the remaining unfunded costs as a level amount or a level percentage of compensation over the remaining future service of each employee, or (2) 10 percent of the cost that would be required to fund or purchase such medical benefits completely. Certain contributions in excess of the deductible limit may be carried over and deducted in succeeding taxable years.

Welfare benefit funds

An employer may establish a welfare benefit fund to provide for post-retirement medical benefits. A welfare benefit fund is, in general, any fund which is part of a plan of an employer, and through which the employer provides welfare benefits to employees or their beneficiaries.

If a welfare benefit fund satisfies certain requirements, the fund generally will be exempt from income tax. In general, to be tax-exempt, the fund is required to be a voluntary employees' beneficiary association (VEBA) (sec. 501(c)(9)) providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, and no part of the net earnings of such association may inure (other than through such payments) to the benefit of any private shareholder or individual. In addition, the VEBA generally is required to satisfy certain rules prohibiting the provision of benefits on a-basis that favors the employer's highly compensated employees.

Although a VEBA generally' is exempt from tax, it is taxable on its unrelated business taxable income (UBTI). Income set aside to provide for post-retirement medical benefits is considered UBTI, although this rule does not apply to a VEBA if substantially all of the contributions to it were made by employers who are exempt from income tax throughout the 5-taxable-year period ending with the taxable year in which the contributions were made.

Certain special rules apply to the deductibility of employer contributions to a welfare benefit fund without regard to whether the fund is a VEBA. Under these rules, contributions by an employer to such a fund are not deductible under the usual income tax rules (sec. 162), but if they otherwise would be deductible under the usual rules, the contributions will be deductible within limits for the taxable year in which such contributions are made to the fund.

The amount of the deduction otherwise allowable to an employer for a contribution to a welfare benefit fund for any taxable year may not exceed the qualified cost of the fund for the year. The qualified cost of a welfare benefit fund for a year is the sum of (1) the qualified direct cost of the fund for the year and (2) the addition (within limits) to the qualified asset account under the fund for the year, reduced by (3) the after-tax income of the fund.

In general, the qualified direct cost of a fund is the aggregate amount expended (including administrative expenses) that would have been allowable as a deduction to the employer with respect to the benefits provided, assuming the benefits were provided directly by the employer and the employer was using the cash receipts and disbursements method of accounting. In other words, the qualified direct cost generally represents the amounts expended during the year for current benefits.

A qualified asset account under a welfare benefit fund is an account consisting of assets set aside to provide for the payment of disability payments, medical benefits, supplemental unemployment compensation benefits or severance pay benefits, or life insurance benefits. Under present law, an account limit is provided for the amount in a qualified asset account for any year.

The account limit with respect to medical benefits for any taxable year may include a reserve to provide certain post-retirement medical benefits. This limit allows amounts reasonably necessary to accumulate reserves under a welfare benefit plan

so that funding of post-retirement medical benefits with respect to employees can be completed upon the employees' retirement. These amounts may be accumulated no more rapidly than on a level basis over the working lives of employees with the employer. Funding is considered level if it is determined under an acceptable funding method so that future post-retirement medical benefits and administrative costs will be allocated ratably to future preretirement years.

Each year's computation of contributions with respect to post-retirement medical benefits is to be made under the assumption that the medical benefits provided to future retirees will have the same cost as medical benefits currently provided to retirees. Because the reserve is computed on the basis of the current year's medical costs, neither future inflation nor future changes in the level of utilization may be taken into account until they occur.

The Deficit Reduction Act of 1984 (DEFRA), which added the deduction limitations for contributions to welfare benefit funds, directed the Secretary of the Treasury to study the possible means of providing minimum standards for employee participation, vesting, accrual, and funding under welfare benefit plans for current and retired employees. The study is to include a review of whether the funding of welfare benefits is adequate, inadequate, or excessive. The Secretary was directed to report to the Congress with respect to the study by February 1, 1985, with suggestions for minimum standards where appropriate. The Tax Reform Act extended the due date for the study to October 22, 1987. This study has not yet been completed.

Qualified plan distributions

An individual may use some or all of a distribution from a qualified plan to acquire post-retirement medical benefits. Such amounts are taxable to the individual under the rules applicable to distributions from qualified plans. Qualified plans thus provide an additional. indirect means of funding post-retirement medical benefits, although the tax treatment is less favorable than if retiree health benefits are provided directly by the employer.

D. MINIMUM STANDARDS

Under present law, minimum standards of the type applicable to tax-qualified pension plans generally do not apply to post-retirement medical benefit plans. Under both the Code and the Employee Retirement Income Security Act of 1974 (ERISA), qualified retirement plans are required to meet minimum standards relating to participation requirements (the maximum age and service requirements that may be imposed as a condition of participation in the plan), vesting (the time at which an employee's benefit becomes nonforfeitable), and benefit accrual (the rate at which an employee earns a benefit).

Also, minimum funding standards apply to the rate at which employer contributions are required to be made to ensure the solvency of pension plans. In general, the benefits provided by defined benefit pension plans are guaranteed by the Pension Benefit Guaranty Corporation (PBGC) in order to prevent loss of benefits in the event an employer terminates a plan while it is in financial distress and has not adequately funded pension benefits.

Except for certain nondiscrimination and basic qualification rules, such minimum standards and requirements do not apply to post-retirement medical benefit plans.

Because post-retirement medical benefits are not subject to the same minimum standards applicable to qualified retirement plans, employees rights to such benefits depend on the particular contractual arrangement between the employees and their employer. The binding nature of such arrangements, as they relate to post-retirement medical benefits, has been the subject of recent litigation. Case law has focused on the right of the employer to terminate post-retirement medical benefits with respect to current retirees. In general, the courts have affirmed an employer's right to terminate a retiree health plan if such right has been unambiguously reserved and clearly communicated to employees. However, the courts have been strict in applying these standards, looking not just at plan documents but also to oral representations. In cases, for example, in which representatives of the employer have told retirees that their benefits would continue for the remainder of their lives, courts have held that the employer could not terminate the retiree health benefits after the employee had retired.

E. FIDUCIARY RULES

ERISA contains rules governing the conduct of fiduciaries of employee benefit plans. These rules generally apply to all employee benefit plans subject to ERISA, including both employee benefit pension plans and welfare benefit plans. Thus, these rules apply to post-retirement medical benefit plans. ERISA has general rules

relating to the standard of conduct of plan fiduciaries, and also specific rules prohibiting certain transactions between a plan and parties in interest with respect to a plan, such as a plan fiduciary.

The general fiduciary standard under ERISA requires that a plan fiduciary discharge his or her duties with respect to a plan (1) solely in the interest of the plan participants and beneficiaries, (2) for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable administrative expenses of the plan, (3) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, and (4) in accordance with the documents and instruments governing the plan to the extent such documents and instruments are consistent with ERISA.

F. REPORTING AND DISCLOSURE

ERISA contains reporting and disclosure rules that apply to all employee benefit plans, including post-retirement medical benefit plans. These rules generally require that a plan be in writing, and that certain information with respect to a plan be provided to plan participants and to the Department of Labor. Annual reports on welfare benefit plans are also required to be filed with the Internal Revenue Service.

II. Analysis of Tax Incentives for Prefunding Retiree Health Liabilities

There have been numerous proposals made in the retiree health area that would allow more extensive tax-favored prefunding by employers of post-retirement medical benefits than is allowed under present law. These proposals generally fall into one of five broad categories that are discussed in more detail below: (1) the VEBA/sec. 401(h) model; (2) the defined health benefit plan; (3) the defined dollar benefit plan; (4) the defined contribution plan; and (5) the qualified retirement plan surplus approach. A key issue in funding post-retirement medical benefits is defining the benefit. Each of the first four categories of proposals defines the benefit in different ways. The fifth funding approach could be used to fund any type of benefit.

The proposals embody several different specific approaches to prefunding of post-retirement health benefits. More generally, there are several approaches which could be taken to address the issue: maintain the present-law tax incentives for prefunding retiree health benefits; create new tax incentives specifically designed to encourage employers to prefund their liabilities; create new specific tax incentives that mandate that employers prefund their liabilities; or mandate the advance funding of liabilities with no change in tax treatment.

A. PRESENT LAW RULES

Recently, there has been increasing focus on the value of post-retirement medical benefits that employers have promised their employees, and the issue of funding those benefits. The concern of employers is, in part, a reaction to the issuance of an exposure draft by the Financial Accounting Standards Board ("FASB") of a proposed Statement of Financial Accounting Standards titled "Employer's Accounting for Postretirement Benefits Other Than Pensions." The exposure draft would require employers subject to the FASB rules to disclose the value of unfunded retiree health liabilities on annual financial statements.

The FASB proposal, when effective, may induce the private market to prefund retiree health liabilities to avoid any adverse effect on an employer's balance sheet. Some believe that the new liability which FASB will require companies to disclose will have negative effects on the solvency or perceived solvency of the employers with significant unfunded liabilities. Corporate financing may be harder to obtain for employers reporting large unfunded liabilities for retiree health benefits and, thus, the accounting change may provide an incentive to reduce these liabilities by prefunding.

Absent changes in the tax law or ERISA, employers would retain flexibility in determining how to best provide funds for the employer's retiree health liability.

Market-induced prefunding, while solving financial statement problems, may not improve the security of benefits for employees or retirees because employers may not set aside assets solely for the benefit of employees. For example, amounts set aside for retiree health benefits may not be protected from an employer's creditors in the event of bankruptcy.

If the capital markets do not react negatively to employers with large unfunded liabilities, in lieu of prefunding its liabilities, an employer may attempt to limit or

terminate existing plans. To the extent that this reduction or termination is prohibited by the courts, employers might limit promises of benefits to new employees. Such a result could undermine a goal of improving retiree access to health care.

Some argue that the FASB accounting change alone will not alter the economic circumstances of the employer, so that the accounting change will have little economic impact on the employer beyond providing more accurate information to shareholders. These people believe that investors already consider potential liabilities of the employer to pay retiree health benefits, and that any decision to fund, expand, or curtail retiree health benefits will be made irrespective of a change in accounting rules.

Health benefits for retirees could also be provided through an expansion of an employer's pension plans. With the increased benefits, the retiree could choose to allocate his or her retirement funds between health care and other expenses as he or she deems best. From the employer's perspective, this option is generally equivalent to all proposals which seek to create a specific tax preference for retiree health benefits, except that the monies promised are not dedicated to health care and the amounts that the employer can prefund are determined by reference to the funding and deduction rules for pension plans, rather than by reference to projected or accrued retiree health liability. This approach could be utilized under present law only by those companies which do not make the maximum permissible pension contributions. Some would argue that full use of the present-law pension funding limits indicates that sufficient tax expenditures have been made to induce employers to assist employees in planning for their retirement income and health care needs.

This approach allows the retiree complete flexibility in providing for his or her needs. Being solely responsible for health care needs gives the retiree an incentive to economize on health care costs. This could reduce some of the pressure on health care costs.

On the other hand, some might argue that retirees may not allocate sufficient amounts of retirement income to health care and that the Federal Government should mandate or encourage benefit programs that insure at least some minimum level of health care. In addition, as with any plan which only provides dollars and not services, the risk of increases in health care costs is borne solely by the retiree.

B. TAX PREFERENCES FOR PREFUNDING

Accelerating the deductibility of employer contributions for retiree health benefits accelerates the revenue loss to the Federal government. Permitting earnings on the funds to accumulate tax free increases the revenue loss to the government. In addition, while pension payments to retirees constitute taxable income, an employer's purchase of health insurance for employees or retirees generally does not, further increasing the revenue loss to the government.

Such tax preferences create subsidies for employees of the limited number of employers who offer post-retirement benefits. This may induce more employers to establish such plans. The earlier funding of such benefits could increase national saving. Nevertheless, as long as the plans are not uniform, the tax subsidy would be distributed unequally across all employers and employees.

Some argue that it is not necessary to create additional tax advantages for funding retiree health benefits, particularly given the fact that very few employers have yet taken advantage of the existing tax-favored means of prefunding (such as the separate account (sec. 401(h)) under a qualified pension plan). The DEFRA limitations on deductions for contributions to welfare benefit funds (discussed above) were enacted as a result of Congressional concern that the prior-law rules, which permitted employers greater flexibility in prefunding, allowed excessive tax-free accumulation of funds. Many of the current proposals for expanding the tax benefits of funding retiree health benefits would reinstate in some form the pre-DEFRA rules.

Congressional concern about the pre-DEFRA rules was caused by discussions among tax practitioners as to the tax-shelter potential of welfare benefit plans, such as retiree health plans. Commentators had pointed out that the combination of advance deductions for contributions and the availability of tax-exemption for certain employee benefit organizations (such as VEBAs) provided tax treatment very similar to that provided to qualified retirement plans, but with far fewer restrictions. This discussion became considerably more active after Congress, concerned that qualified retirement plans were being used to provide excessive amounts of tax benefits to relatively high income individuals, lowered the limits on annual contributions that could be made to qualified retirement plans and the benefits that could be paid out of such plans. Some articles recommended the use of VEBAs to recoup deductions lost in qualified pension plans after the lowering of the contribution and benefit limitations. Congress was concerned that substantial advance funding of wel-

fare benefits could ultimately have led to an unacceptable tax burden for many taxpayers who do not participate in these programs.

Accordingly, Congress provided that, as a general matter, employers should not be permitted a current deduction for welfare benefits that may be provided in the future (i.e., for liabilities that are not accrued). This treatment is consistent with income tax rules in other areas, which generally match the time a payor deducts a payment and the time the payee includes the payment in income.

Congress also found that it was appropriate to permit a reasonable level of reserves for the funding of post-retirement medical benefits, and permitted employers to make deductible contributions to fund for such benefits over the active life of the employee. Some argue that any expansion of the tax benefits for funding retiree health benefits would simply recreate the tax shelter possibilities that existed before the DEFRA limitations.

Some who favor increased incentives to fund retiree health benefits are concerned that smaller employers in particular tend not to offer post-retirement medical benefit plans. The most immediate beneficiaries of tax preferences for prefunding retiree health care would be large employers and their employees. Some assert that the administrative costs per employee of employee benefit programs are lower for large employers than small employers. A tax preference for post-retirement health benefits could offset some of the higher per-employee administrative cost and lead to increased coverage among all employers. However, because large employers already offer such benefits, they would tend to gain the most from any tax preference that is equally available to all employers.

C. MANDATORY VS. OPTIONAL PREFUNDING

Tax-favored prefunding of post-retirement medical benefits could be mandatory or permissive. That is, an employer that has a post-retirement medical benefit plan could be required to prefund the benefits in accordance with specific statutory rules or could be permitted, but not required, to prefund such benefits.

Optional funding has the advantage that it provides an employer with flexibility in meeting its benefit obligations. However, optional funding may result in inadequate funding of retiree health benefits if other incentives to prefund are insufficient. Because very few employers have taken advantage of existing tax benefits for retiree health benefits, employers may not be willing to fund these benefits without mandatory funding rules. On the other hand, some argue that the present-law tax incentives for prefunding retiree health liabilities generally are inadequate to induce employers to prefund such liabilities.

Because the present-law rules for funding post-retirement health benefits are optional, some argue that retiree health benefits are now similar to pension benefits prior to ERISA when employers generally were not required to set aside sufficient funds to pay promised benefits.

Mandating the funding of retiree medical benefits ensures that sufficient funds will be available to provide the promised benefit. On the other hand, some employers may not be willing to accept a new funding obligation. Mandatory funding could discourage employers from establishing retiree health benefit plans in the future or, if the employer already has such a plan, cause the employer to reduce benefits or terminate the plan. (Such effects could also occur if the reaction of financial markets causes employers to fund retiree health benefits.) Mandated pre-funding could also increase the short-term labor costs for some employers, placing them at a competitive disadvantage to both domestic and foreign rivals that do not have such obligations.

D. VEBA/SEC. 401(h) MODEL

As is the case with the following three categories of proposals, the VEBA/sec. 401(h) model would allow more extensive tax-favored prefunding of retiree health benefits by increasing the amount that an employer may contribute to a trust on a deductible basis and/or by increasing the extent to which the income of the trust is exempt from tax. The distinctive element of the VEBA/sec. 401(h) model is that no individual employee would, under the proposals, acquire any right to benefits from the trust. This model does include an incentive for employers to use the trust assets to provide retiree health benefits. Generally, such incentive takes the form of an excise tax applicable to assets diverted to other purposes. However, the additional tax-favored prefunding would be permitted even if an employer retained the right to eliminate all benefits with respect to any individual employee.

The advantage of the VEBA/sec. 401(h) model is the flexibility it provides to employers who can retain the right to change the plan in any way they see fit. One

disadvantage of the VEBA/sec. 401(h) model is that it allows the employer to confer tax-favored retiree health benefits on a narrow, select group (i.e., those who qualify for benefits under the plan). Another disadvantage of this model is that it does not provide any benefit security to any employee, thus interfering with an employee's ability to plan efficiently for his or her retirement. This disadvantage could be addressed through the adoption of certain minimum standards.

As discussed below, H.R. 1213, introduced by Mr. Schulze, is an example of the VEBA model. S. 812, introduced by Mr. Pryor, and H.R. 1865 and H.R. 1866, introduced by Mr. Chandler and others, are examples of expanding the use of section 401(h) accounts.

Other proposals use a variation of the VEBA/sec. 401(h) model under which the use of corporate-owned life insurance (COLI) to fund retiree health benefits is facilitated. The key difference between the COLI variation and the basic VEBA/sec. 401(h) model is that the COLI variation generally does not include a trust. Thus, the employer enjoys current access to the assets, which provides further flexibility for the employer with a concomitant reduction in employees benefit security.

Although it has not been proposed, there is no theoretical reason preventing the use of COLI in connection with the next three prefunding models; the COLI concept is simply a means of obtaining tax benefits.

E. DEFINED HEALTH BENEFIT PLAN

Like the VEBA/sec. 401(h) model, the defined health benefit plan allows more extensive tax-favored prefunding of retiree health benefits. However, unlike the VEBA/sec. 401(h) model, one condition of this more extensive tax-favored prefunding is that individual employees earn rights to benefits under the trust that the employer may not eliminate or modify.

In general, the defined health benefit plan establishes a particular health plan that is the plan benefit. Such a health plan could be described by reference to the plan that is (or was) provided to active employees. An individual employee's right to coverage under this plan during his or her retirement is earned by virtue of the employee satisfying certain service requirements. The statute could limit the length of service an employer could require for coverage under the plan to, for example, 10 years.

The advantages of the defined health benefit plan are the benefit security it provides to the employees and, depending on the length of the service requirement, the breadth of the class of employees benefiting under the plan. Vesting requirements for post-retirement health benefits with a service vesting requirement could induce employees to remain with one employer longer than they otherwise would. This could benefit the employer by making it easier to retain trained employees. On the other hand, labor market mobility could be reduced, making workers slower to respond to new employment opportunities.

There are several disadvantages with this type of approach. First, it is difficult to determine what an appropriate level of funding is, because it is difficult to determine what the benefit will be. Increases in the cost of health care are not easily predictable, thus making it difficult to estimate what the benefit will be worth by the time the employee retires. In addition, changes in health care technology and provider methods may occur, thus altering the benefit promise, and making predictions about the appropriate funding levels inaccurate.

Further, there are underfunding and overfunding problems. With respect to the former, the Federal Government would be required to address the problem that a plan have insufficient assets to pay the promised benefits. Some commentators have raised the possibility of creating a Federal guarantor for this purpose, similar to the Pension Benefit Guaranty Corporation (PBGC), which ensures retirement benefits under defined benefit pension plans. Proponents of a Federal guarantor argue that a guaranty is necessary to ensure that individuals actually receive their benefits. However, the PBGC is currently operating with a deficit, and recent legislation (the Pension Protection Act of 1987) was necessary to address the financial problems of the PBGC. Such financial difficulties could also arise with respect to a Federal guarantor of post-retirement medical benefits. Indeed, such a guarantor could be required to pay benefits in more situations than the PBGC because of the difficulty of estimating future health care costs.

With respect to overfunding, the problems that have arisen with respect to qualified retirement plans would be present. Appropriate limitations would be necessary so that employers may not use the post-retirement medical plan as a tax-favored bank account. Thus, limitations on the amounts that are deductible would be necessary. In addition, the problem of what to do with any excess assets, (e.g., do they

belong to the employer, or does some or all of any excess belong to the employees) which is currently an issue in the pension area, would need to be addressed.

If an individual employee's benefit is expressed in terms of a health plan, rather than a dollar amount, certain administrative problems arise. For example, it is difficult to have employees earn rights in a health plan gradually over time. Some sort of cliff vesting and accrual of employee's rights thus may be necessary. Also, this type of arrangement makes it difficult for employees to accumulate benefits earned from different employers without inefficient duplication of benefits.

An additional actuarial difficulty exists in determining the extent of the future liability incurred by such a plan. It is a more difficult task to account for price changes in a specific sector than for overall costs. For example, a pension fund can invest in assets such as corporate securities or real estate which typically appreciate as the overall cost of living increases, and thereby insure their promise to provide a prespecified, inflation-adjusted income level. Such a strategy would not be as effective for provision of health services, the price of which has been rising and may continue to rise substantially faster than the overall price level.

As with pension plans, employers typically impose a service requirement before the retiree health benefit is vested in the employee. Because retiree health plans generally specify health coverage levels rather than dollar levels, problems can arise with vesting policies. While complete vesting for pension benefits typically means different retirees receive different retirement incomes based upon their years of service and income, complete vesting for retiree health benefits usually implies full coverage in a group health insurance plan. Unlike pension plans, many retiree health plans require the employee to have been employed immediately before his or her retirement in order to be vested. Consequently, portability of retiree health benefits is more limited than portability of pension benefits. Estimating the funds required for prefunding, therefore, depends upon estimates of the number of employees who will remain with the firm until retirement.

Altering vesting requirements to more closely parallel those for pension plans creates other potential problems. If, for example, 10 years of service were required for complete vesting in any employer's plan, it would easily be possible for one retiree to be completely vested in two or more different health insurance plans. This could create problems of coordination of multiple health insurance policies held by the retiree, and further complicate the calculation of the employer's future liability. Similarly, the concept of partial vesting is difficult to implement when the benefit is measured in units of service rather than measured in dollars.

A substantial advantage to the retiree of a defined health benefit plan is that the risk of cost increases for health care is substantially borne by the employer. As health care costs rise, subject to the employer's co-insurance rate, the increases in cost are borne by the employer because of the promise to provide a specified level of medical coverage.

F. DEFINED DOLLAR BENEFIT PLAN

The defined dollar benefit plan is similar to the defined health benefit plan except that the benefit is expressed not in terms of a specific health plan, but in terms of an annual dollar benefit. This dollar benefit would be available to provide health benefits to employees in their retirement. The amount could be paid directly to an insurance company for coverage of employees, could be used by the employer to fund its own self-insured plan, or could be paid to the employee to reimburse him or her for the cost of purchasing health insurance or medical expenses.

The advantages of this type of plan are based on the fact that it is expressed in terms of a dollar amount, rather than a particular health plan. This makes the employer's costs more predictable and controllable. Moreover, the administrative problems described above with respect to the defined health benefit plan do not exist.

One disadvantage of the defined dollar benefit plan is that it shifts to the employees the risk of health care inflation, making it more difficult for employees to plan with certainty for their retirement. As in the case of the defined health benefit plan, a second disadvantage involves the risk of underfunding and the controversy surrounding overfunding. A third disadvantage is that because the benefit is expressed in terms of dollars, there will be constant pressure to allow the money to be diverted to purposes other than retiree health benefits. This would be similar to the pressure to allow use of qualified retirement plan assets for nonretirement purposes.

An employer could accomplish a similar result to this method (and the method described in G. below) under present law through the use of a qualified plan. The employer could provide increased qualified retirement plan benefits, and then the retiree could use the benefits to purchase health insurance. Of course, under this

method, the tax consequences to the employee would be different because distributions from qualified plans are includable in income.

G. DEFINED CONTRIBUTION PLAN

The defined contribution plan is similar to the defined dollar benefit plan except that each employee has an account under the plan to which a portion of every employer contribution is allocated, rather than earning the right to an annual dollar benefit. That account grows like a tax-deferred bank account, earning income that is retained in the account. Upon an employee's retirement, the assets in the account are available to provide health benefits in the same way as the annual dollar benefit under the defined dollar benefit plan.

The advantage of the defined contribution plan approach is its relative simplicity. The underfunding and overfunding problems do not exist, nor do the administrative problems associated with the defined health benefit plan. Moreover, the employer's obligation is even more limited than under the defined dollar benefit plan. Because the employer is not promising a specific dollar benefit, it bears no risk of poor investment return. In additions accumulated benefits in a defined contribution plan may not be forfeited if the employee changes jobs, thereby making the retiree health benefits more portable.

The disadvantages of the defined contribution plan generally fall into two categories. First, the employees not only bear the risk of health care inflation, as in the case of the defined dollar benefit plan, but also bear the risk of poor investment return. (This can be mitigated to some extent by the use of a type of defined contribution plan, a "target benefit plan," that adjusts for poor investment return.) This makes it even more difficult for employees to plan efficiently for their retirement. Second, the pressure to allow use of the trust assets for purposes other than retiree health benefits will be even more acute than with respect to the defined dollar benefit plan. The use of individual accounts makes the plan seem more like a bank account available for any purpose. This issue is similar to that in the qualified retirement plan area in which the pressure for nonretirement use of assets is much more acute in the case of defined contribution plans and individual retirement arrangements (IRA's).

H. QUALIFIED RETIREMENT PLAN SURPLUS APPROACH

Under the qualified retirement plan surplus approach, excess assets in defined benefit retirement plans are used to fund retiree health benefits. This is achieved by transferring the excess assets to a separate retiree health benefit trust or to a separate account within the retirement plan trust (i.e., a sec. 401(h) account), or by permitting the excess assets to be used to pay for current retiree benefits. Under the qualified retirement plan surplus approach, this transfer may not be subject to income tax or to the excise tax on reversions (sec. 4980) from retirement plans.

The qualified retirement plan surplus approach may be combined with one of the four models described above by the use of one of such models in the trust or account to which the excess assets are transferred.

The advantage of the qualified retirement plan surplus approach is that it provides employers with the opportunity to satisfy at least some portion of their retiree health obligations without the use of assets that are easily available for other purposes. Viewed another way, this approach enables employers access to retirement plan surplus without any adverse tax consequences.

One disadvantage of this approach lies in its similarity to the VEBA/sec. 401(h) model. An employer is able to create deliberately a retirement plan surplus. Thus, this approach enables an employer to build a-tax-favored fund to use for future retiree health benefits without at the same time providing employees with vested rights to such benefits.

This approach could also undermine the full funding limitation, which caps the amount of deductible contributions that may be made to qualified plans. If assets are transferred from a fully funded plan out of the qualified plan, leaving the plan below the full funding limitation, the employer is entitled to deduct additional contributions that otherwise would not be deductible.

Another disadvantage to this approach is that it may jeopardize the benefit security of the participants in the retirement plan. It is necessary to determine what level of assets should be left in the retirement plan to assure benefit security.

This approach also raises issues as to who the surplus assets belong to, the employer or the employees. For example, should the participants in the post-retirement medical benefit plan be the same as the participants in the retirement plan, or can

the excess assets be used for the benefit of a completely different group of employees?

Permitting employers to use excess retirement plan assets for this purpose may also create pressure to permit employers to withdraw pension plan assets for other purposes.

Some have argued that the use of excess pension assets to fund retiree health benefits is, at best, a partial solution to the problem of funding such benefits, since it can only be used by a limited number of employers. Thus, it is argued that a more comprehensive funding method would be more appropriate.

It has also been suggested that in the future there are likely to be fewer overfunded pension plans because the full funding limit was redefined in the Revenue Act of 1987. Thus, it has been suggested that this approach is only temporary, and might best be viewed as a stop-gap approach until more comprehensive rules can be enacted.

III. Description of Proposals

A. S. 1812 [3]—Senator Pryor

The bill would expand the present-law rules relating to the use and funding of section 401(h) accounts. These accounts would be permitted to provide for long-term health care benefits, as well as post-retirement health care.

The bill would revise the funding limits applicable to section 401(h) accounts. Under the bill, benefits under a section 401(h) account would be deemed to be subordinate to the pension benefits under the plan if the annual contributions to such account with regard to a participant do not exceed certain amounts. For a defined benefit plan, an employer could contribute the amount actuarially determined to be necessary to fund an annual benefit commencing at retirement of $2,500 for medical benefits and $2,500 for long-term care benefits. For a defined contribution plan (i.e., a money purchase pension plan), the employer could contribute annually to a section 401(h) account an amount not in excess of $825 for medical benefits and $825 for long-term care benefits. These funding limitations would be indexed.

The bill would permit an employee to enter into a salary reduction arrangement (meeting the requirements of section 401(k)) by which the employee could contribute to a section 401(h) account.

Under the bill, an employer would be permitted to withdraw certain excess assets from an on-going defined benefit plan and transfer such amounts to a section 401(h) account. Assets remaining in the plan after such transfer could not be less than the amount of assets necessary to satisfy 125 percent of the plan's current liability. The amount of assets that could subsequently be withdrawn would be reduced if the employer withdraws assets within 5 years of the last such withdrawal. The amount withdrawn would not be subject to income tax or the 15-percent excise tax on reversions from qualified plans.

In order to withdraw assets from a defined benefit plan, an employer would be required to notify its employees and the Secretary of the Treasury. No withdrawal would be permitted until 60 days after such notice. Conforming amendments would be made to Title I of ERISA that would permit withdrawals from on-going plans.

Effective date.—The bill would be effective upon enactment.

B. House Committee on Ways and Means Proposal on the Use of Excess Pension Plan Assets to Pay Current Retiree Health Benefits [4]

Under the proposal, a one-time transfer of certain assets would be permitted from a defined benefit pension plan to the section 401(h) account that is a part of such plan.

The assets transferred would not be included in the gross income of the employer nor subject to the 15-percent excise tax on reversions. The transfer would not disqualify the defined benefit pension plan, nor violate the present-law requirement that medical benefits under a section 401(h) account be subordinate to the retirement benefits under the plan. The employer would not be entitled to a deduction

---

[3] The "Retiree Health Benefits Preservation Act of 1989" was introduced by Mr. Pryor on April 17, 1989. H.R. 1865, introduced by Mr. Chandler and others on April 13, 1989, contains the same provisions as S. 812.

[4] The Committee on Ways and Means adopted this proposal on July 12, 1989, as set forth in the Joint Committee staff document, "Description of Revenue Reconciliation Proposal by Chairman Rostenkowski" (JCX-28-89), July 11, 1989.

when such amounts are transferred into the account or when they are used to pay retiree health benefits.

In order to qualify for the tax treatment described above, the transfer of assets to a section 401(h) account would be required on or before December 31, 1991. In addition, the benefits of plan participants would be subject to the same rules that would apply if the plan had been terminated. Thus, each participant's benefits must be fully vested and an annuity must be purchased to fund such benefits.

The amount of excess assets that could be transferred and used for retiree health benefits would be limited to the lesser of (1) the assets in excess of the full funding limitation (using 140 percent of current liability instead of 150 percent); and (2) the assets needed to satisfy current retiree health liabilities.

Current retiree health liabilities would be defined as the amount of retiree health benefits estimated to be paid or incurred by the employer during the employer's 1990 and 1991 tax year for employees who have retired as of the date of the transfer.

The amounts transferred to the section 401(h) account would be required to be used to pay current retiree health benefits. In addition, no deduction would be allowed for 1990 and 1991 for the payment of retiree health expenses except to the extent such payments exceed the amount transferred to the section 401(h) account (including any income thereon). Similarly, no contribution may be made by the employer to a section 401(h) account or a VEBA for expenses relating to retiree health benefits for the 1990 or 1991 plan years that may be funded by the excess assets transferred to the section 401(h) account. Any transferred amounts that are not expended for such liabilities are included in gross income, and are subject to the excise tax.

If an employer transfers assets under this proposal, the employer would be subject to a modified definition of full funding. For the plan year in which the transfer occurs, and for the immediately succeeding 4 plan years, the full funding limit with respect to the plan from which the assets were transferred is modified to use 140 percent (instead of 150 percent) of the plan's current liability.

Under the proposal, regardless of whether the employer transfers excess assets, no contribution would be permitted to a section 401(h) account if the employer is precluded from contributing to the pension plan containing such account because the plan has assets in excess of the full funding limitation. This rule would not apply to a transfer of assets made pursuant to the proposal.

Effective date.—The provision generally would apply to plan years beginning after December 31, 1989. With respect to the rule prohibiting contributions to section 401(h) accounts contained in fully funded plans, the proposal is effective for plan years beginning after December 31, 1989.

C. INDUSTRY GROUP PROPOSAL ON USE OF EXCESS PENSION PLAN ASSETS [5]

Under the proposal, excess pension plan assets would be available for voluntary transfer to a retiree medical trust ("RMT") to pay health benefits for retirees. The amount eligible to be transferred, the recoverable pension surplus, would be the difference between the lesser of market or actuarial value of assets in the pension plan and the lesser of (1) 100 percent of "actuarial accrued liability" plus normal cost as of the latest valuation (including the effects of future pay increases) or, (2) 125 percent of current liability.

Amounts transferred would not be subject to income and excise tax and no vesting or annuitization of pension liabilities for active or retired employees would be required.

Assets available for transfer would be limited to the amount of eligible retiree health liability (including a provision for medical cost trend and medical inflation) for current retirees at the date of transfer. The eligible group includes all retirees who have health care coverage at company expense.

The initial transfer would be permitted at any time at the employer's discretion as long as the conditions for transfer are met on that date. A maximum of three transfers would be permitted in a ten year period.

Assets that were transferred would not be used to provide retiree health benefits for retirees other than those who were participants in the transferor plan except as provided below.

---

[5] This proposal has been developed by an industry group known as the Coalition for Retirement Income Security ("CRIS"). The description of the proposal reflects the written testimony of John E. Stair, Jr. before the Oversight Subcommittee of the House Ways and Means Committee on June 14, 1989.

Transfers would be reflected as plan amendments for the purposes of minimum and maximum pension funding rules. In the event of a certified actuarial surplus, the eligible group could be enlarged to include new current retirees. After satisfaction of all liabilities under the plan(s), excess assets in the RMT shall revert back to the pension plan from which the funds were drawn.

Income earned on assets transferred to the RMT would remain free of income tax or unrelated business income tax. No minimum standards (e.g., coverage, nondiscrimination, vesting or minimum funding requirements) would apply to the RMT. The RMT would be permitted to provide different levels of retiree health benefits according to the provisions of the health care plan(s).

D. H.R. 1213 [6]—MR. SCHULZE

Under the bill, a reversion from an overfunded pension plan would not be included in the gross income of the employer and would not be subject to the 15-percent excise tax on reversions if the employer transfers more than 50 percent of such reversion to a qualified retiree health trust.

The bill also would allow an employer to withdraw certain excess assets from a defined benefit plan (other than a multiemployer plan) without terminating such plan. This withdrawal would not be treated as a reversion subject to the income and excise tax on reversions. The assets remaining after the withdrawal could not be less than those assets necessary to satisfy 115 percent of the accrued benefits under the plan. Further, in no event could the assets remaining after the withdrawal be less than the assets which would be necessary to satisfy all termination liabilities. The amount of assets that could subsequently be withdrawn is reduced if the employer withdraws assets within 5 years of the last such withdrawal.

In order to withdraw assets from a defined benefit plan, the bill would require the employer to notify its employees and the Secretary of the Treasury of the planned withdrawal. No withdrawal is permitted until 60 days after such notice. Conforming amendments would be made to Title I of ERISA to permit withdrawals from ongoing plans.

Under the bill, amounts withdrawn from an ongoing plan or transferred upon the termination of a plan would be contributed to a qualified retiree health trust. This trust would be tax-exempt and would be required to be maintained for the exclusive benefit of the employees. Contributions and benefits under the trust could not discriminate in favor of highly compensated employees.

The bill would also allow the Secretary of the Treasury to guarantee certain loans the proceeds of which are to be transferred to a qualified retiree health trust. Certain employers with operating losses or loss carryforwards would be eligible for these loans.

The bill would increase the full funding limit from 150 percent to 200 percent of current liability. Under the bill, the excise tax on reversions from qualified plans would be increased from 15 to 20 percent of the amount of the reversion.

Effective date.—The bill would be effective on the date of enactment.

E. H.R. 1866 [7]—MR. CHANDLER AND OTHERS

The bill contains all the provisions of S. 812 as well as other provisions.

Under the bill, the excise tax on reversions (sec. 4980) would be increased from 15 percent to 100 percent. The amount of the reversion would no longer be subject to income tax. If the employer withdraws and transfers such excess assets to a section 401(h) account, those amounts would not be subject to income or excise tax.

The bill would repeal that portion of the full funding limit that prohibits an employer from contributing to a defined benefit plan if the plan has assets equal to or greater than 150 percent of its current liabilities.

Under the bill, a plan would not be a qualified plan if it permitted a distribution prior to the participant attaining age 59½ and if the distributions are more rapid than the rate of distributions under an annuity for the life of the participant. Exceptions to this requirement would include: (1) distribution to a beneficiary upon the death of the participant; (2) distributions on account of the participant being disabled; (3) distributions on account of hardship; (4) distributions after the participant separates from service and has attained the age of 55 (as long as the otherwise applicable rate of distribution requirements are met); (5) transfers to other retirement

---

[6] The "Worker Health Benefits Protection Act of 1989" was introduced by Mr. Schulze on March 1, 1989.

[7] The "Retiree Health Benefits and Pension Preservation Act of 1989" was introduced on April 13, 1989, by Mr. Chandler and others.

programs; (6) distributions pursuant to qualified domestic relations orders; and (7) distributions for medical expenses that are described in section 213. The bill would clarify that the last category of distributions would include distributions for expenses related to nursing home care or for long-term care (including premiums for insurance).

Under the bill, the additional income tax imposed on early distributions (sec. 72(t)) would be increased from 10 to 20 percent.

Finally, the bill would require certain employers to provide their employees with the opportunity to create a simplified employee pension account.

Effective date.—The bill would be effective upon enactment.

PREPARED STATEMENT OF REPRESENTATIVE ROD CHANDLER

Thank you, Senator Matsunaga and Senator Pryor for, the opportunity be appear before your subcommittees today.

There are 25 million current workers whose employers have promised them health coverage in their retirement years. I'm tempted to say that the promise is threatened by the doctors and the bookkeepers, but it's a little more complicated that than.

This promise is at risk, and the difficulty we're experiencing on both sides of the Capitol in dealing with the Medicare Catastrophic Health Care Act—a program that seemingly few seniors want and even fewer want to pay for—should underscore the importance of making sure that benefits promised to current workers are secure.

The benefits of current retirees are for the most part protected when explicit or implicit promises have been made. But the benefits of current workers are at risk.

That's because medical inflation continues to skyrocket—in double digits—and because new accounting rules will require companies to account for these obligations as a current liability on their financial statements.

The equity and bond markets are going to note these changes, and companies with large new liabilities on their books may face major financial dislocation.

What does all this mean for workers? It means that many employers are going to be tempted to retreat from the promises they've made to current workers.

And, unfortunately, our tax laws conspire with medical inflation and the FASB standard to encourage employers to do just that.

Current tax law encourages employers to meet this liability on a pay-as-you-go basis. You can take a deduction when you provide the benefits. But if you want to pre-fund the benefits that's the way pensions are usually financed—it is nearly impossible to take a deduction for pre-funding.

That's why the senator from Arkansas and I have introduced the Retiree Health Benefits Preservation Act." We want to make sure that tax law—in a post-FASB environment—doesn't force employers to bail out of the promises they're making to workers.

Our bill gives employers flexibility to use current arrangements—Section 401(h) accounts—to prefund retiree health benefits. And it also allows employers who have large surpluses in their pension plans to use some of the surplus to prefund coverage.

In order to hold the line on the cost of this proposal, contributions to these accounts would have to fall within the limits on pension plan contributions.

It has been suggested that allowing the transfer of surplus pension assets to pay for the benefits of current retirees—and remember, their benefits are already protected—would be a good starting point. And that's a politically attractive proposal, because with the right bells and whistles you can raise revenue with it. But make no mistake, it is less than half a loaf.

If we're going to protect the interests of workers, we're going to have to take a comprehensive approach to this difficult problem. Transferring surplus pension assets may raise some revenue, but pre-funding is going to lose revenue. And if we start skimming off the cream before we put together a comprehensive approach, we run the risk of ending up with considerably less than skim milk. We may end up with nothing at all.

I don't mean to sound like a scold. But the retiree health benefits of 25 million workers hang in the balance.

I'm humbled by the fact that we don't know what to do about 35 million uninsured Americans. And we haven't quite figured out how to make Medicare meet the catastrophic expenses of the elderly. But 25 million workers stand to get a good deal of help from their employers in their retirement years. We should help make sure that happens.

United States of America

Congressional Record

PROCEEDINGS AND DEBATES OF THE 101st CONGRESS, FIRST SESSION

Vol. 135 WASHINGTON, TUESDAY, MAY 2, 1989 No. 52

House of Representatives

RETIREE HEALTH CARE: PROMISES TO KEEP

HON. ROD CHANDLER

OF WASHINGTON

IN THE HOUSE OF REPRESENTATIVES

Tuesday, May 2, 1989

Mr. CHANDLER. Mr. Speaker, The retiree health benefits promised to many of the Nation's workers may be put at risk by an exposure draft released by the Financial Accounting Standards Board on February 14. The temptation is to shoot the messenger, but FASB isn't creating a liability, it is merely bringing it into focus.

Regardless of how one feels about the merits of the proposed ruling, FASB has focused considerable attention on a terribly important issue. It was easy enough, and I would add that it was good citizenship, for employers to promise retiree health benefits in the 1960's. Health care costs were lower, life expectancy was lower, and there were fewer retirees. The current level of health care inflation, and the sheer size of the work force that is approaching retirement, will make those promises, more difficult to keep.

The way employers finance these benefits can be contrasted to the funding of pension plans. Pension contributions are set aside when the promise is made—while people are still in the workforce—and the employer deducts the contribution to the plan. Most retiree health benefits aren't prefunded, but are financed on a pay-as-you-go basis. FASB is suggesting that this retiree health care liability should be noted on a company's ledger as it is accrued. That requirement will radically alter the balance sheets of a number of companies, and, as a result, many employers will be tempted to back away from these promises.

The tax treatement can be contrasted as well. Contributions to pension plans are, for the most part, deductible to the employer. Employers usually have to wait until benefits are provided to deduct the costs for providing retiree health coverage.

My friend and colleague from Alabama [Mr. FLIPPO] and I have introduced two bills addressing this challenge. One addresses the more narrow issue of retiree health care, and the second addresses the need for a more coherent national retirement policy.

In recent years, the need to raise revenue and the need to address perceived abuses has resulted in a rather piecemeal approach to retirement income policy. That's understandable, but the result doesn't always make sense.

For instance, a plan sponsor sitting on a tremendous surplus in a pension plan can't transfer the assets to a retiree health plan. But plan sponsoprs can and do use pension resources to finance corporate takeovers. Granted, an excise tax has to be paid if a plan is terminated in a corporate takeover, but shouldn't good public policy encourage the use of pension surpluses to meet the needs of retirees?

Or to give another example: Current law provided for 5-year vesting in order to broaden pension coverage. But in an increasingly mobile workforce, employees are taking lump sum distributions, as they change jobs, and spending them. At retirement, the money is long gone. That hardly serves our policy interest.

Mr. Speaker, retiree health benefits and retirement income policy are part of the same fabric. Without adequate retirement income, people can't meet their out-of-pocket expenses. And in the absence of adequate health coverage, medical costs will deplete a retiree's resources.

That's why the second bill the gentleman from Alabama and I have introduced addresses both retiree health and pension policy.

H.R. 1866 would allow plan sponsors to fund retiree health accounts under section 401(h). Retiree health policy can and should be coordinated with pension policy.

It would allow plan sponsors to use surplus pension assets to fund retiree health benefits.

In a world without a free lunch, the bill eliminates asset reversions. Employers would no longer be allowed to terminate pension plans and take reversions. Surplus pension funds could be used to fund retiree health plans, or ESOPs—as provided under existing law—but plan sponsors would have to give up reversions.

If plan sponsors can't take asset reversions, there's really no need for the 150 percent full-funding limitation. The bill would repeal the limitation, so plan sponsors could fund heavily in profitable years as a hedge against lean years.

To make sure that retirees have the income they need to meet their out-of-pocket medical expenses, the bill attempts to broaden pension participation and to make sure money onginally set aside for retirement is actually there when an individual retires.

Under the bill, any employee whose employer doesn't offer a qualified pension plan would be allowed to set up a salary reduction SEP [Simplified Employer Plan]. The employee would have to find someone to administer the SEP, a bank or a savings and loan, for instance, and the employer would be obliged to forward the employee's contribution to the institution.

Finally, in order to establish once and for all that assets accumulated on a tax-favored basis will actually provide retirement income, the bill would prohibit distributions before retirement and would prohibit lump sum distributions. The money would have to be paid out in a stream of payments over the life expectancy of the retiree.

We've also introduced the provisions related to prefunding retiree health coverage and the transfer of surplus pension assets in a separate bill, H.R. 1865.

A section-by-section summary of these two measures follows:

SECTION-BY-SECTION SUMMARY OF H.R. 1866 CHANDLER-FLIPPO RETIREE HEALTH AND PENSION BILL

Section 1. Short title. This Act may be cited as the "Retiree Health Benefits and Pension Preservation Act of 1989."

Section II. Findings. As the United States prepares for the retirement of the baby boom generation, the largest generation in our nation's history, the need for a strong commitment of employer and individual resources for pension and medical care is greater than ever. Accordingly, the Congress hereby finds that:

1. Adequate income and health care coverage are both necessary for a secure retirement and are inextricably linked.

2. Old-Age, Survivors, and Disability Insurance provides a base for retirement income security, but is not designed to be the sole source of retirement income. Retirement income security is enhanced by multiple sources of income: Social Security Act coverage, employer-provided pension coverage and savings. The vitality of the employer-provided pension system is critical.

3. Likewise, Medicare is a primary payor for medical coverage for retirees, but cannot provide complete coverge. Employer-sponsored plans and private coverage can provide a useful suppiement.

4. A healthy pension system is not only critical to the security of the nation's workers and retirees, it is an important source of investment capital and, therefore, critical to a strong economy.

5. Tax policy should encourage employers to sponsor pension and retiree health coverage.

6. While tax-favored coverage should be provided on a fair and equitable basis, the rules of enforce non-discrimination should not be so administratively cumbersome as to discourage the provision of benefits. Plan

sponsors need flexibility to deliver diverse benefits to meet diverse needs.

7. Retirees need adequate retirement income, in addition to insurance, to supplement Medicare.

8. Our tax laws should provide a meaningful incentive for every working American to contribute to a pension plan.

9. Our tax policy should favor remaining in the work force and should not favor early retirement. As Americans live longer, people should be encouraged to retire at later ages.

10. Resources accumulated on a tax-favored basis for pension and health case should be used solely for those purposes.

11. Employers should be encouraged to pre-fund retiree health and long-term care benefits because pre-funding is cost-effective and provides for greater benefit security.

TITLE I—EXPANSION OF POST-RETIREMENT HEALTH CARE AND LONG-TERM CARE BENEFITS WHICH MAY BE PROVIDED BY PENSION PLANS

Section 101: Pension plans permitted to provide expanded post-retirement health care benefits and to provide long-term care benefits.

Section 101(a): Safe harbors for the providing of medical and long-term care benefits. Creates safe harbors for prefunding medical and long-term care coverage associated with a pension plan by waiving the requirement that the coverage be subordinate to the pension plan. The subordination requirement is waived to the extent that coverage in a defined benefit plan does not exceed $2500 in annual premium costs for retiree health benefits and/or $2500 in annual premium costs for long-term care coverage, or to the extent that employer contributions under a defined contribution plan do not exceed $825 a year for medical coverage and/or $825 a year for long-term care coverage. These amounts are indexed in the same manner as the section 415 limits.

Section 101(b): Medical and long-term care benefits subject to section 415 limit. Contributions to these 401(h) retiree medical and/or long-term care accounts must fall within the existing pension contribution limits, and separate accounts must be maintained for medical and long-term care benefits.

Section 101(c): Cash or deferred arrangements may be used to fund accounts for retiree medical and long-term care benefits. Employer contributions to 401(k) plans may be used to fund 401(h) retiree medical and/or long-term care benefits.

Section 101(d): Effective date. The amendments made by this section shall apply to years beginning after the date of enactment.

Section 102: Withdrawal or transfer of excess assets from single employer defined benefit pension plans without plan termination to fund retiree medical and long-term care benefits.

Section 102(a): Amendment of Internal Revenue Code of 1986. General Rule: Surplus pension plan assets may be withdrawn provided that (1) the amount withdrawn does not exceed the excess of 125% of current liability, (2) the employees and the Treasury Secretary are notified of the withdrawal, and (3) the amount withdrawn is immediately transferred to a 401(h) for the plan participants. (The amount that can be withdrawn within a 5-year period is limited by an averaging rule.)

Section 102(b): Amendments to the Employee Retirement Income Security Act of 1974. ERISA is amended in the same manner as the Internal Revenue Code is amended in Section 102(a).

Section 103: 100 percent excise tax on employer reversion: exception for transfers of assets to accounts for retiree medical and long-term care benefits.

Section 103(a): Increase in tax on employer reversions. The fifteen percent excise tax on reversions of qualified pension plan assets is increased to 100%. Reversions on which the 100% excise tax has been paid will be excluded from income (so the tax liability for a reversion does not exceed 100%).

Section 103(b): Special rules permitting transfers from overfunded plans to fund accounts for retiree medical and long-term care benefits. Money transferred from a reversion to 401(h) retiree health and/or long-term care accounts shall not be included in the gross income of the plan sponsor or subject to the excise tax.

Section 103(c): Effective date. The amendments made by this section shall apply to transfers after the date of enactment of this Act.

Section 104: Repeal of the 150 percent full funding limitation.

TITLE II—CERTAIN EMPLOYERS REQUIRED TO OFFER SIMPLIFIED EMPLOYEE PENSIONS FUNDED BY SALARY REDUCTION ARRANGEMENTS

Section 201: Requirement that certain employers offer simplified employee pensions.

Section 201(a): General Rule. Employers with five or more employees performing more than 1,000 hours of service during the previous calendar year are required to arrange a salary reduction SEP for any employee with one year of service who has reached the age of 21. This requirement does not apply to any employer who offers a qualified plan. The employee is responsible for selecting a trustee (e.g. a bank, savings and loan, investment broker) to administer the plan. The employer's responsibility is limited to forwarding the salary reduction contribution to the trustee within seven days after the pay period. (Under current law, salary reduction SEP contributions are limited to $7,627 per year.)

Section 201(b): Contributions not subject to Social Security or unemployment taxes.

Section 201(c): Effective date. The amendments made by this section shall take effect one year after the date of enactment.

Section 202: Limitation on distributions from qualified retirement plans.

Section 202(a): Plan qualification requirements. As a condition of plan qualification, distributions may not be made before a participant reaches the age of 59½, and distributions must be made in a stream of payments (or annuity) form over the life expectancy of the participant.

These limitations do not apply.

—to distributions made to a beneficiary (or estate) upon the death of the participant, to a disabled participant or in the event of a participant's separation from service after reaching the age of 55. In the case of early retirement, distributions must be made in a stream of payments form.

—to direct transfers to eligible retirement plans.

—to distributions to a participant for medical expenses to the extent that they are deductible under section 213 or attributable to long-term care expenses.

These plan qualification requirements apply to all section 401 plans, to section 403(b) annuities, to section 404(a) annuities, individual retirement accounts and individual retirement annuities.

Section 202(b): 20-percent additional tax and distributions violating qualification requirements. Any distribution which is not permitted under the provisions of section 202(a) of the bill is subject to a 20 percent excise tax.

Section 202(c): Effective dates. In the case of plans in existence on the date of enactment, the amendments made by this section shall apply to distributions made two years after the date of enactment. In the case of new plans, the section shall take effect upon enactment.

Section 203: Pension portability. The Treasury Secretary shall conduct a study of the current rules applicable to transfers of assets between qualified plans and between qualified plans and individual retirement accounts or annuities when an employee separates from service. The report and recommendations shall be submitted to Congress within six months of enactment.

SECTION-BY-SECTION SUMMARY OF H.R. 1865 CHANDLER-PEPPO-PETOR RETIREE HEALTH BILL

Section I. Short title. This Act may be cited as the "Retiree Health Benefits Preservation Act of 1989."

Section II. Pension plans permitted to provide expanded post-retirement health care benefits and to provide long-term care benefits.

(a) Safe harbors for the providing of medical and long-term care benefits. Creates safe harbors for prefunding medical and long-term care coverage associated with a pension plan by waiving the requirement that the coverage be subordinate to the pension plan. The subordination requirement is waived to the extent that coverage in a defined benefit plan does not exceed $2500 in annual premium costs for retiree health benefits and/or $2500 in annual premium costs for long-term care coverage, or to the extent that employer contributions under a defined contribution plan do not exceed $825 a year for medical coverage and/or $825 a year for long-term care coverage. These amounts are indexed in the same manner as the section 415 limits.

(b) Medical and long-term care benefits subject to section 415 limit. Contributions to these 401(h) retiree medical and/or long-term care accounts must fall within the existing pension contribution limits, and separate accounts must be maintained for medical and long-term care benefits.

(c) Cash or deferred arrangements may be used to fund accounts for retiree medical and long-term care benefits. Employer contributions to 401(k) plans may be used to fund 401(h) retiree medical and/or long-term care benefits.

(d) Effective date. The amendments made by this section shall apply to years beginning after the date of enactment.

Section III. Withdrawal or transfer of excess assets from single employer defined benefit pension plans without plan termination to fund retiree medical and long-term care benefits.

(a) Amendment of Internal Revenue Code of 1986. General Rule: Surplus pension plan assets may be withdrawn provided that (1) the amount withdrawn does not exceed the excess of 125% of current liability, (2) the employees and the Treasury Secretary are notified of the withdrawal, and (3) the amount withdrawn is immediately transferred to a 401(h) for the plan participants. The amount of any withdrawal which meets with requirements of this section shall not be included in the gross income of the employer maintaining the plan and is exempt from the excise tax on reversions. (The amount that can be withdrawn within a 5-year period is limited by an averaging rule.)

(b) Amendments to the Employee Retirement Income Security Act of 1974. ERISA is amended in the same manner as the Internal Revenue Code is amended in Section 102(a).

PREPARED STATEMENT OF PAUL R. HUARD

I thank Chairman Matsunaga and Chairman Pryor for allowing me to testify this afternoon. My name is Paul R. Huard, and I am Vice President of Taxation and Fiscal Policy of the National Association of Manufacturers. I am pleased to come before the Senate Finance Subcommittees on Taxation and Debt Management and Private Retirement Plans and Oversight of the Internal Revenue Service to present the views of our members on employee stock ownership plans (ESOPs) and retiree health benefits.

Our statement is structured in two parts. Part I will focus on ESOPs, with specific reference to proposed legislation, the economic benefits associated with ESOPs, and the relationship that exists between ESOPs and corporate benefit programs. In Part II, we will examine the issue of retiree health care, including the impact of proposed accounting changes, emerging medical and demographic trends, and various legislative proposals.

EMPLOYEE STOCK OWNERSHIP PLANS

Tax Policy Aspects Of ESOPs

As a general principle, alterations of the Internal Revenue Code should not be driven solely by the need to offset revenue losses or meet deficit reduction targets. Tax code changes proposed primarily for these purposes often do not result in effective, consistent and stable tax law. The employee stock ownership plan legislation that has been introduced in both chambers seems to be fueled by the overriding need to increase revenue, not by the policy issues surrounding the value of ESOPs as an employee benefit or to the economy. NAM believes ESOPs have successfully provided employees with an opportunity to acquire stock in the company for which they work-a benefit that traditionally has been believed to help increase employee productivity and commitment to the success of his firm. NAM holds that recent attempts to halt the expansion and creation of ESOPs are, therefore, misguided.

Provisions Relating to Dividend Deductibility

The ESOP provisions that have emerged from the House Ways and Means Committee would effectively prevent the formation of future ESOPs. The most deleterious provision is the repeal of the Section 404(k) dividend deduction. Section 404(k) allows a corporation a deduction for dividends paid on employer securities held by an ESOP to the extent that the dividends are paid out currently to plan participants or used to repay a securities acquisition loan. The ESOP proposal currently included in the reconciliation package before the House Ways and Means Committee would basically repeal the ESOP dividend deduction applicable to dividends paid on stock acquired after July 10 of this year. The proposal would not repeal the deduction for dividends paid on stock purchased with a loan that would be grandfathered from its repeal of the Section 133 partial interest exclusion-basically, loans secured after July 10.

NAM believes that all corporate dividends should be deductible in adhering to the principle that income taxes should be levied on net, not gross, business income. Currently, dividend payments are doubly taxed-once to the corporation and again to the individual. This double taxation applies to no other form of corporate payment, and it has the effect of penalizing equity financing. With respect to eliminating this double taxation, a recent internal NAM study indicates that there would be substantial benefits from either a dividends-paid deduction or a dividends-received exemption. The dividends-paid deduction would have the same kinds of effects on the economy as any substantial reduction in effective corporate tax burdens, generating a rapid rise in investment and overall output. The dividends-received exemption would be the equivalent of a small tax cut for individuals. Additionally, as Congress continues to examine the issue of mergers and acquisitions and the treatment of corporate debt and equity, allowing some deductibility of corporate dividend payments has emerged as a step toward balancing debt and equity taxation. The enactment of the Section 404(k) deduction was a step in the right direction. NAM believes repealing the provision in order to raise less than $370 million in FY 90 would be grave error.

Unlike the ESOP provision that has emerged in the context of House budget reconciliation legislation, the ESOP proposal sponsored by Chairman Bentsen, S. 1303, does not repeal the Section 404(k) deduction. S. 1303 would, however, effectively repeal the Section 133 interest exclusion available to ESOP lenders. Under current law, a bank, insurance company, or regulated investment company may generally exclude from gross income 50 percent of the interest received from a loan made to purchase stock for an ESOP. Even though the dividend deduction would remain

intact under S. 1303, many NAM member companies would find it difficult to establish new ESOPs or significantly expand current ESOPs without the benefit of this exclusion.

Small Company Provisions

NAM applauds the S. 1303 provision that attempts to protect small companies from the effect of the legislation. The provision exempts firms in which at least 30 percent of stock is held by an ESOP. While the intent of this provision is noteworthy, NAM maintains that there are still many small firms with ESOPs, or establishing ESOPs, that would be hard pressed to pass the "30 percent test." NAM would support lowering this threshold to the greatest extent possible.

Distribution of Wealth

Numerous studies have pointed out that the distribution of income and wealth in the United States tends to be more regressive than in most of the major industrial countries. This regressivity is particularly serious in holdings of corporate stock. According to a study released by the Joint Economic Committee in 1983, fully 46.5% of the corporate stock in the United States was owned by the highest 0.5% of households. An additional 13.5% was owned by the second highest 0.5%, and 29.3% was owned by the 90 to 99th wealthiest households. The remainder of households owned only 22.2% of the stock. These figures are mitigated somewhat by the fact that the distribution of wealth in the form of home equity is less regressive. Nevertheless, when gross assets—consisting of real estate, stock, other financial instruments, and business assets—are added up and debt is subtracted to give an estimate of net worth, fully 41.8% of the net worth in the United States in 1983 was owned by the top 1% of households, while 29.9% was owned by the next 9% and 28.2% was owned by everyone else.

Under the circumstances, increased creation of and access to ESOPs would mitigate the current inequality in the distribution of corporate stock ownership. By shifting ownership of stock in corporations to the workers, the total stockholdings of the middle class would be increased, while the stockholdings of the highest income groups would be proportionally diminished. Passage of ESOP proposals before us would exacerbate rather than mitigate existing inequalities.

A second advantage of ESOPs is that this is a way in which wealth can be acquired by workers without recourse to excessive debt. One of the reasons why the net worth' of the middle class has increased less rapidly during the 1980's is that their key source of wealth—residential housing—must be acquired through leverage, typically at high interest rates. During the last decade, the indebtedness of the private sector has increased to the highest levels as a share of GNP since 1929. The increased use of ESOPs would enable the middle class to increase its wealth without taking on additional debt, and would enable some households to shift their wealth portfolios away from debt-financed assets toward stock acquired as part of normal compensation.

Transition Provisions in Legislation

NAM does not favor passage of legislation scaling back the ESOP-related interest exclusion or dividend deductions. If such proposals were enacted, however, NAM would favor transition provisions that protect ESOPs being established in good faith at the time such proposals were introduced. Senator Dole's ESOP proposal, S. 1171, allows for reasonable transition relief by stating that Section 133 repeal would not apply in certain instances where written documentation produced on or before June 6, 1989, described a planned ESOP transaction. Among other transition provisions, S. 1171 would also not apply in cases where a loan is used to acquire stock purchased by the employer on or before June 6, pursuant to a corporate resolution adopted on or before that date providing for the sale of the stock to the ESOP. Additionally, the repeal would not apply if a public announcement of the ESOP was made by the employer on or before June 6. If ESOP legislation is to be adopted, the association would strongly urge that, at the very least, such legislation be enacted on a prospective basis only, in order to protect those companies which have already undertaken the establishment of their ESOP.

ESOPs and Corporate Benefit Programs

The NAM is greatly concerned by the potential impact of the proposed ESOP legislation on corporate benefit plans. Specifically, we fear that if either bill is passed as currently written, they will ultimately discourage employers from establishing these plans in the future. While such results may seem desirable from a revenue standpoint, they will also minimize the important positive effects ESOPs can have on employee morale and corporate performance.

Studies by the U.S. General Accounting Office illustrate that among the most compelling reasons for employers establishing ESOPs are the desire to provide an employee benefit and the wish to improve employee productivity. Other studies have found that employees endorse the idea of ownership and appreciate the financial benefits it provides. Moreover, there is evidence to suggest that ESOP companies can and have out performed their industries in terms of profit and employment growth.

Clearly, there is a variety of reasons an employer may have for establishing an ESOP or any other employee benefit plan. We strongly believe, however, that decisions regarding the design and funding of such benefit plans should not be mandated or restricted by Congress or the courts. Instead, those decisions should be left to the individual employers who are best able to determine the needs of their employees and their companies. This point will be further illustrated in our discussion of the retiree health issue.

RETIREE HEALTH CARE

The Changing Environment of Retiree Health Benefits

Retiree health benefits first appeared in corporate benefit plans during the mid-1960s as a supplement to the government-sponsored Medicare program. By 1986, 76 percent of full-time health plan participants in medium and large firms had coverage continued after early retirement; 90 percent after age 65. The retiree health concept, therefore, is not a new one, nor is the concern over the means available to employers to pay for these benefits.

FASB

Proposed accounting rules to be issued by the Financial Accounting Standards Board will soon require employers to reflect on corporate balance sheets the unfunded liabilities attributable to retiree health benefits. Although questions remain regarding the administrative burdens presented by this formidable task, one notion appears unshakable: The financial implications of the new FASB rules will be staggering for many companies.

Estimates of the unfunded liability attributable to retiree health benefits range from the Department of Labor's conservative figure of $98 billion to the nearly $2 trillion reported by the House Select Committee on Aging. The U.S. General Accounting Office has estimated the liabilities to date at $220 billion, rising to over $400 billion when future service is taken into account. These figures alone are alarming. Of greater importance, however, is the potential impact these figures could have on corporate ledgers. The Employee Benefit Research Institute has reported that under the proposed FASB rules, the median Fortune 500 company could realize a reduction in net income of 30 to 60 percent. Given that impact, it is not unreasonable to assume that a company's entire business operation could be adversely affected as revenues and profit, credit ratings and operating costs are all negatively impacted.

Health Costs and Demographics

In the past, companies could more easily meet retiree health obligations because medical costs were lower and retirees represented a relatively small portion of the employee population receiving benefits. With medical inflation nearing twenty percent, corporate health costs are no longer as easily managed. Other related factors—changes in health care utilization and delivery, discoveries in medical science and increased longevity—all have their impact on health care costs.

In addition, America's baby boomers are quickly coming of age and the percentage of retirees is growing. Studies show that the current ratio of workers to retirees at the average U.S. company is about 3 to 1. By the year 2000, that ratio is expected to drop to about 2 to 1. Since an aging population obviously means more retirees to care for, this demographic trend will only exacerbate the funding problems associated with providing health benefits to the elderly.

Legislative/Regulatory Trends

The NAM is concerned that Federal legislation to date has failed to respond to the tremendous financial impact expected from the proposed FASB rules, as well as the demographic and medical cost trends noted above. Certainly, change of this magnitude demands public policy which recognizes the implications of these factors and attempts to address them accordingly. Moreover, we are concerned that recent pension legislation has been driven to a greater extent by revenue considerations rather than sound benefits policy.

As a result of these demographic, medical cost, and accounting changes, employers will soon be faced with a difficult decision: specifically, how to continue to provide meaningful retiree health benefits while at the same time reduce the financial liability associated with those benefits. Unfortunately, current law does not provide a ready answer to this question. In fact, recent changes in the tax code have only complicated the problem. The Deficit Reduction and Fiscal Responsibility Act of 1984 and the Tax Reform Act of 1986 severely restricted the few means available to employers to prefund retiree health benefits on any kind of tax-favored basis. Ironically, this revenue-riven legislation was being drafted concurrently with the public's emerging recognition of the scope of the retiree health issue.

In response to this changing environment, employers have been forced to consider alternative methods of reducing the burgeoning liability associated with retiree health plans. Some of these alternatives—cost management devices, use of Preferred Provider Organizations, and other design innovations—have proven effective but limited. More common is the growing tendency of employers to cut back on retiree benefits (to the extent the courts will allow) or to increase the cost to retirees of receiving these benefits. Less common, but of equal concern, are employer decisions not to offer retiree health benefits of any kind. Granted, many courts have held that an employer cannot unilaterally terminate an existing plan for current retirees. There is no law or precedent, however, that requires an employer to offer such a plan for future retirees. Given the lack of fiscal or legislative incentives, more employers are likely to consider this option in the future. The NAM believes this is unfortunate, since most employers would prefer to offer these benefits rather than be forced to reduce or eliminate them due to economic realities.

Toward Improved Health Benefit Security

The NAM recognizes the important role employers play in providing adequate retirement security for workers. To that end, the NAM supports the voluntary establishment of retiree benefits, including both pension and health and welfare plans. Such plans ultimately are good for both employees and employers, and thus should be encouraged by Congress.

This is not to suggest that Congress has altogether ignored the factors that have contributed to the emerging retiree health care crisis. We appreciate the efforts of Senator Pryor, and those of other members in both the House and the Senate to address this important issue.

The NAM believes that Senator Pryor's proposed legislation, S. 812, is noteworthy primarily because it attempts to address the issue of retiree health within the context of the existing retirement system. This is a positive step toward a national policy that recognizes the inherent relationship between health care, retirement and long-term care considerations. We believe this is a solid foundation on which to build.

Specifically, we applaud the bill's provisions allowing pretax contributions to fund retiree health and long-term care benefits. Such provisions are critical if we are to encourage more employers to provide these valuable benefits. In addition, we strongly support the inclusion of provisions allowing employers to transfer surplus pension assets to fund retiree health benefits. Such transfers would permit employers to maintain healthy, ongoing pension plans while providing for a more efficient allocation of corporate resources.

In this regard, it is important to note that, once again, Congress has been presented with a proposal, S. 685—now under consideration by the Senate Labor and Human Resources Committee, to severely restrict, if not effectively prohibit, the ability of employers to recover surplus assets from a terminated pension plan. The NAM strongly opposes S. 685 on the grounds that such restrictive legislation will discourage many employers from adequately funding their pension plans, and many others from even offering these plans. In Senator Pryor's bill, by contrast, Congress has a unique opportunity to address the issues of excess asset reversions and retiree health care in a way that ultimately benefits employees, employers and the Federal Government.

The NAM has reviewed other retiree health proposals, including provisions recently approved by the House Ways and Means Committee during discussions on budget reconciliation. As noted, the NAM advocates legislation that would allow employers to utilize surplus pension assets for other employee benefit purposes. Unfortunately, we cannot support the Ways and Means proposal allowing such transfers. Our greatest concern stems from the proposal's inclusion of vesting and annuitization requirements which are unduly restrictive and unnecessary to protect participant benefit security. In addition, the proposal does not allow companies sufficient time or flexibility to adequately address retiree health concerns due to the

short time frame in which they can take advantage of the transfer mechanism. Finally, we are concerned that the proposal does not address the needs of other employers who may wish to fund retiree health benefits, but are prevented from doing so because they do not have sufficiently overfunded pension plans. It appears that the Ways and Means proposal, as with most recent employee benefits legislation, is driven more by short term revenue concerns than by thoughtful, long term benefit policy considerations.

In short, the NAM supports the principles upon which Senator Pryor has based his proposal and we endorse his comprehensive approach. We must stress, however, that this or any other proposal in this area should not achieve its goals at the expense of employer flexibility. Employers must be allowed to respond to the changing conditions that are unique to each industry. The same principle must hold true for corporate benefit plans. To do otherwise, be it through legislative mandates or excessive regulations, will ultimately do more harm than good.

CONCLUSION

The NAM shares the concerns of the Subcommittees regarding the issues of ESOPs and retiree health care. Due to its far-reaching implications, any congressional action in these areas will likely have a significant and lasting impact on employees and employers alike. Primarily, NAM believes that changes in the Internal Revenue Code should not be driven solely by the need to offset revenue losses or meet deficit reduction targets. Congress should refrain from attempting to raise revenue at the expense of sound tax or benefits policy. Therefore, NAM opposes legislation that would impede the creation and expansion of ESOPs and retiree health plans. Instead, we urge Congress to consider measures that would encourage employers to establish corporate benefits programs that are beneficial to their employees, their companies and the overall economy. We welcome the opportunity to work with you in this endeavor.

PREPARED STATEMENT OF STEVEN R. KOCH

Mr. Chairman, my name is Steven R. Koch. I am the Vice President/Treasurer of The Peoria Journal Star, Inc., Peoria, Illinois.

I am also the Treasurer of the Employee Stock Ownership Association, headquartered here in Washington, DC. I testify for the approximately 1100 ESOP company members, and the approximately 500 associate, educational, and international members.

Before beginning our discussion of issues pertaining to S. 1303 and S. 1171, let us note that leveraged ESOPs are involved in a small percentage of corporate debt transactions. Since 1984, when the leveraged ESOP tax incentives were adopted, until January 1, 1989, 2% to 3% of all corporate debt transactions involved ESOPs, representing 5% to 7% of the value. I might add, even after January 1, 1989, when the number of ESOPs created by publicly-traded companies increased greatly, the percentage of ESOP transactions compared to all debt transactions is approximately 10% to 15% by dollar volume.

We do not support, in any way, S. 1171, which would repeal Code Section 133, which provides that an ESOP lender may exclude 50% of its interest income from a qualified ESOP loan.

As to S. 1303, specifically, the ESOP Association expresses reservations about the 30% threshold before the ESOP lender's partial interest exclusion is available.

Our large publicly-traded company members, such as Ashland Oil, Enron, among others, make a convincing case that the 30% or more threshold would require too much leverage, and triggers a variety of outside stockholder concerns. Ironically, many feel that a move to acquire that large a bloc of stock for the employees may trigger some stockholders, particularly the Wall Street arbitrage people, to put the company into play as a takeover target. If the Committee decides to adopt a threshold that affects publicly-traded corporations, please consider a lower threshold.

Why is the ESOP lender partial interest exclusion so important?

Because before this provision became law, leveraged ESOP companies were few in number. Of the few with significant payrolls, only a handful were strong, growing companies.

In several instances where an ESOP existed before 1985 in a large company, the employees were the buyers of "last resort." This is not the case after 1984, when DEFPA added this ESOP incentive to the Code. In other words, no longer are employees the least preferred borrower compared to the other financial players, such as corporate raiders, LBO firms, and the already rich.

Now, I turn to the second major part of S. 1303--the mandate for full voting rights pass-through. Because current law requires full voting rights pass-through for allocated stock on *all* issues if a publicly-traded corporation sponsors an ESOP. they are *not,* affected by the proposed legislation.

Current law also requires significant voting rights pass-through an allocated stock when a closely-held, non-publicly traded company sponsors an ESOP.

In fact. the only issue of significance not mandated for pass-through. in a closely-held ESOP company is the vote on the Board of Directors.

Now that we know what the debate is about, may I make a few points:

1. Voting rights pass-through is an issue that frequently wanes as the company's founder-owners, management, and employees become more comfortable with significant employee ownership through the ESOP. Many closely-held companies, after a few years, voluntarily decide to have employees vote on the Board of Directors. We note the House version of TRA 86, which contained numerous ESOP "reform" provisions, required full pass-through for employees with 10 years of participation in the ESOP. This approach eliminates the apprehension that short-term employees, not familiar with company history, culture, and the ownership of stock, will join an ill-founded attempt to remake the Board. And, conversely, it gave the vote to employees who have the largest allocated accounts, and thus have the most at stake, a vote on the Board membership.

2. Many of the most productive closely-held ESOP companies, with employees getting very rich, do not have pass-through on Board of Directors votes.

3. We see a woeful lack of understanding of the meaning and responsibility of ownership of corporate stock. Many of our companies spend thousands of dollars teaching basic economics, profit and loss concepts, and stock owner responsibilities. We would urge this Committee, the Appropriations Committee, or someone to help set up a program to help educate all ESOP employees on the basic concepts of free enterprise, capitalism, stock voting responsibilities and so on. As employee ownership grows, this becomes a key element, in our view.

4. Voting pass-through does not lead to employee participation in day to day decisions affecting employees lives at work. Frankly, many publicly-traded companies with pass-throughs do not have participation programs, linked to ownership. Participation programs without ownership is akin to sharecropping in our view. We do strongly believe ownership through the ESOP should be coupled with participation. But, some of the best employee participation programs exist in closely-held ESOP companies which do not have full voting rights pass-through.

5. Many ERISA plans invest in employer stock. These are 401(k) plans, savings plans, and profit sharing plans. Some profit sharing plans are primarily invested in employer stock., None of these plans are subject to any voting pass-through requirements. In fact, it was this committee, and not just Senator Long, that pushed hard in the 1981 House-Senate Conference on ERTA, to exempt profit sharing plans from voting rights pass-through. Also, note the ESOP, because of TRA 86, has many protections for the participants, in addition to voting rights, that these other plans do not have. These employee protections are, among others, diversification, puts, and mandated independent valuations.

We appreciate, Mr. Chairman, that S. 1303 requires the full pass through in closely-held companies only when the ESOP lender partial exclusion is utilized. But, we want the Committee to have the full range of discussion of this frequently debated issue, when it debates S. 1303.

Finally, it is important to remember that the small business, closely-held corporations are still the backbone of the employee ownership movement. For example, the National Center for Employee Ownership (NCEO) estimates that approximately 220 leveraged ESOP transaction occurred in the first half of 1989. Of those, 150, or 70%, were less than $10 million in value. So the big mega-deals may attract the attention of the financial press, but small business is still most interested in employee ownership. We estimate that 75 to 100 of these transactions involved 30% plus ESOPs. It is these companies that may back away from ESOP creation if votes on the Board of Directors are required to be passed-through. This is a shame, because after a few years, they would be the companies with the greatest employee ownership culture.

In sum the ESOP Association endorses current law with regard to voting pass-through because it recognizes the dynamics of closely-held companies, with generally few shareholders, and few employees, compared to publicly traded corporations.

Turning to another subject, many are linking the ESOP lender partial interest exclusion to the ESOP dividend deduction—Code Section 404(k). A few say repeal both; some say impose a threshold on both. You know that the House Ways and Means Committee endorsed a 30% threshold.

The ESOP Association supports maintaining the ESOP dividend deduction as is.

Many of the same arguments made for the 50% interest exclusion may be made for the ESOP dividend deduction.

Furthermore, the ESOP dividend deduction also has the advantage of eliminating the double taxation of corporate income.

Here are more facts supporting the ESOP dividend deduction:

1. The ESOP dividend goes directly to the employee in cash, or in more stock;
2. The ESOP dividend deduction has led to the use of convertible *preferred* stock—with high dividends, highest voting power, and a set conversion price, that eliminates some risk of downward stock prices. This is *preferred* stock;
3. Because the ESOP dividend is not a plan contribution under 415 limits, many corporations can maintain other plans while having a significant ESOP; and
4. Even with the increased creation of ESOPs, the ESOP dividend deduction revenue costs are only about 25% of those arising from the ESOP lender interest exclusion.

We urge the Committee and Senate to maintain the position implicitly set forth in S. 1303—no change in the ESOP dividend deduction.

Why do we want to defend ESOPs? Why do we believe? As an executive and employee of an ESOP company, I can tell you why. The Peoria Journal Star, Inc. publishes the largest daily circulation newspaper in Illinois outside the City of Chicago. In addition, we publish six special interest magazines with both domestic and international circulation.

In December 1986, we borrowed $25,000,000 to finance generally a transaction increasing the employee ownership of the company from 28% to 82%. This stock was purchased at $71.45 per share and is currently appraised at $125.72, a 76% increase in value. Given the 1987 stock market crash, I defy anyone who claims our employees would be better off with a diversified, Wall Street portfolio.

We have paid to date $7,880,000 in dividends to reduce the $25,000,000 ESOP debt. The current appraised value of allocated ESOP shares is $40,218,000. For employees leaving the company, mainly retirees, we paid $4,000,000 in benefits in 1987-88. We will pay another $2,000,000 this year.

Do not tell me that the Peoria Journal Star and its employees are not benefiting from the ESOP tax code provisions provided by Congress or that our ESOP does not benefit our employees. I know better.

All over the world people struggle with this concept of ownership. More and more people want to turn away from ownership by the state, or ownership by a few. So far, only the ESOP, under U.S. laws and regulations, represents a successful model for addressing either concern.

While we know mid-course adjustments in employee ownership laws may be needed, we submit overall we are on the right track with ESOPs.

We appreciate your attention, and that we are able to address ESOP issues with you in a collegial, instead of an adversarial manner.

Prepared Statement of Russell B. Long

WHY IMPEDE EMPLOYEE STOCK OWNERSHIP?

In terms of foreign policy, someone once pointed out that even if the nation had no policy at all—the lack of any position should be regarded as our policy until such time as one emerged. On that basis, it would appear that the U.S. supports a policy of extreme concentration of wealth.

About 1% own approximately 50% of all stocks and bonds. The next 14% own most of the remainder. Very little of it is held by 85% of our people.

Most Americans who own something have an *equity* interest in a home or an automobile, but the overall distribution is nothing to brag about.

The top 15% have about 85%.
The next 35% own about 10%.
The next 35% own about 5%.
The remaining 15% own 0%.

Why has Congress done so little to improve on those relative numbers? If anything the trend in recent years seems to be moving toward making a bad situation worse.

Why has the Congress not at least required a study to enable us to keep score on how we are doing? If we could only agree that we need broader ownership and that we are willing to pay a price to move in that direction, even that would help.

At least a previous Congress made the interest expense of a home loan deductible, and a previous Congress made it deductible from income for an employer to establish a pension plan, profit sharing plan, 401(k) plan, a health plan or an ESOP plan for the benefit of the employees.

While some may complain about an increase of numbers of those in poverty during his administration, President Ronald Reagan was a consistent supporter of ESOPs and during his administration, much was done to increase the tax advantages of ESOPs—probably more than any other president.

Have we gone too far in that direction? Judging from the available data, one would hardly think so.

In 1988, the U.S. economy undertook $741 billion in capital financing including:

—$311 billion in mergers and acquisitions (by way of 3,637 transactions) plus
—$430 billion in new plants and equipment.
—yet less than $6 billion (1%) was financed by way of ESOPs

Admittedly, the fear of the raiders has caused more companies to establish or expand their ESOPs. But, in view of the very small part of the economy that is in ESOPs, could we not at least wait until the 1989 figures are in before we cut back on ESOPs rather than jumping to the conclusion that a very tiny relative shift in the economy is a matter of the gravest concern?

I am an adviser to Kelso and Company which owns controlling stock of 31 companies—none of which were financed by use of Section 133 thanks to the overly protective attitude of the Department of Labor.

Every one of our companies have ESOPs ranging from 5% to 40%. We are in it as a matter of dedication that goes back to Louis Kelso who first envisioned the ESOP approach. He is a director.

We are opposed to any abuse or unintended application of the tax benefits. We have demonstrated our sincerity by supporting this committee repeatedly in trimming back on tax advantages where they were not intended. We stand by to help again.

As the original author of the provisions which this measure would amend, I doubt that anyone who served on this committee when I was a Senator doubts my sincerity in the matter.

We do not want anyone to abuse the legislation that we supported. However, we would like the opportunity to reason with the members and staff of this committee before it drops a guillotine on something that may not be an abuse at all.

Let me just offer an example by way of illustration:

The IRAs have been very popular. They were used far more than anyone anticipated. They cost the treasury many billions beyond the original estimate. In due course, they were cut back to help pay for the 1986 Tax Reform Bill. But they had their day in court. And they were not cut by means of a reconciliation bill which can be a sort of bum's rush short-cut of the legislative procedure.

Now let us look at Section 133. We originally passed that measure because banks, insurance companies and major lenders generally were not willing to even consider making ESOP loans.

Thanks to Section 133, banks, insurance companies, and now many other lenders are not only willing, but anxious to make good ESOP loans.

The potential use of the section by investment banking firms like Merrill Lynch, Salomon Brothers, and Goldman-Sachs was envisioned from the beginning. This competition among lenders can only assure that most, if not all, of the tax benefit will be passed through to benefit the employees. Already most of the benefit is being passed through to the intended beneficiaries—the workers—but there is still room for improvement and more competition among responsible qualified lenders can do nothing but help the program.

Are some aware of an abuse here? If so, why not focus on it and correct it?

If someone fears that a bank or other lender is charging too much, how can it do anything but help to subject that lender to a lot of new competition from other lenders?

The proposed answer in the House of Representatives was to abolish all future use of the Section. No showing was made of any abuse, much less consideration of how the remedy could be limited to apply to the area that needed attention.

Even if the lender was passing through *all* of the tax benefit, the answer was the same "off with their heads."

Congressman Beryl Anthony fought a valiant fight to save what he could.

Unfortunately, the 30% rule he was successful in obtaining would kill the tax advantage for over 90% of the loans in terms of dollar volume.

I am pleased to be a board member of Lowe's Companies, one of the "white hat" companies if ever there was one. The genesis of our ESOP started before anyone knew what ESOP meant.

The principal shareholder, Carl Buchan, died in 1960, leaving his stock—48% of the entire company—to the employees. First the directors put the stock in a profit sharing plan. To fulfill a fiduciary duty, the company was forced to diversify its stock, reducing to about 17% the Lowe's stock held. Thereafter the company turned to an ESOP. The ESOP now holds around 20% of the stock.

I understand Lowe's has already created some 50 millionaires. In fact, with over 200 stores, I understand that an employee with 25 or more years who is a store manager will typically retire with over $1 million.

The Chief Executive Officer and Chairman, Robert Strickland, was honored by serving as President of the ESOP Association, among many other honors.

But judging by the 30% test, Lowe's should be in the category of the guys with the black hats!

The section should be stricken!

I know that some may suggest a compromise with the House bill.

The problem is that the House conferees headed by Congressman Rostenkowski can be tough. If the Senate proposed a 15% rule compared to the 30% for example, one would have little chance of obtaining better than a 50-50 compromise. That would leave you at a 22½% figure, which in my judgment will still be much too high.

In my judgment, you may be compelled to compromise in conference, so you will desperately need a strong position in the beginning.

Now let me speak to Section 404(k). That is in the House Bill, but, thank the Lord, it is not in any of the Senate Bills, at least not yet.

The purpose of 404(k) was to encourage ESOP companies to pay out some dividends to the employees or to accelerate repayment of an ESOP loan. Section 404(k) makes the dividend deductible to the employer as would be the case of an employee's bonus or a pay raise.

Without the provision, companies preferred to pay the money in ways that it would be deductible. There are several ways that the money could be made deductible to the corporation.

But to enable the great majority of employees to know that someone was holding for their account something of substantial value—a dividend from time to time really helps. It causes the employee to be made aware of the amount of his stock and its value.

Believe me, I know from talking to the troops, the dividend is a great morale and psychological booster. In some cases, employees are not really aware of what they have until they see a check.

Finally, let me discuss voting rights.

When we first accepted an amendment to require a pass through of voting rights in the case of the old investment tax credit of 1% for ESOP, it drastically slowed down the rate at which ESOPs were being formed.

The law and the common practice today is for a company to pass through voting rights to the employees. In fact, many of them even proceed to require the trustee to vote the unallocated stock in the same proportionate manner as the employees decide to vote their allocated stock.

I really do not think the amendment is necessary and ESOPs are over regulated already both by D.O.L. and by the Treasury. For example, to install an ESOP in your company is almost to guarantee that your company will have an IRS audit—enough to deter a lot of good companies right there.

But, I would most strongly urge that the voting rights provisions should not be extended to the many small companies, most of whom would not put in an ESOP, for fear that employees or their representatives would find themselves in a conflict with management.

Under the law as it stands, the employees are assured the pass through of voting rights even in small companies where the so called major issues are concerned. As a practical matter, that usually includes almost everything except the election of the board of directors.

However, some of the small companies fear that a tough labor leader might seize upon the voting rights to dictate a policy that management cannot accept, thus bringing discord to a program that was intended to bring better understanding.

A highly respected businessman, known to all of you, made the problem clear to me.

He said that he had given a great deal of his stock to the employees. He would give them a lot more and in his will they would receive most of his stock.

However, if the Congress required that the employees vote the stock, then he was not going to put it in and ESOP.

The Mondale Amendment requiring pass through voting in a limited situation, was enough to scare him away from ESOP. Recently, I was told that the company now has a large profit sharing plan which does not involve the voting rights, but only a small ESOP.

There is one situation, however, where I do strongly favor a requirement of pass through voting rights.

Wherever a takeover, merger, or sale of the company is involved, I think that the employees should be able to require that their stock be voted to protect their interest which is usually their jobs.

In that case, I think that the trustee should be required to vote both the allocated stock as well as the unallocated stock of the ESOP as the workers desire. To do otherwise is to deny the employee—shareholder the right to vote to save his job which may be all that stands between him and poverty. In that particular situation, the employee's right to vote might mean more to him than the stock itself.

Mr. Chairman, I do not say that ESOP will solve all of our problems, but it will solve many. It should be accompanied by the best of management personnel policies to dignify the employees and to make them know that they are appreciated. Employee participation is very important.

But not everybody can be expected to do all the right things at one time. We will make more progress if we let ESOP and employee participation each sell themselves on their own merits. It would be a shame to lose either by insisting on both simultaneously.

I have been working in the ESOP vineyard for 16 years, since the night I first met Louis Kelso. I expect to do whatever I can to help as long as I can be effective. It seems to me that the ESOP approach can help make our system one where we apply the golden rule as a standard, and it will be just as good for us as for our neighbors.

PREPARED STATEMENT OF SENATOR HOWARD M. METZENBAUM

Thank you for the opportunity to testify before the Committee this afternoon. I am chairman of the Subcommittee on Labor, which also has jurisdiction over pension and employee benefit plans. For more than a decade, I have worked to protect the retirement needs of working men and women. I appreciate the opportunity to share my thoughts with this Committee.

In 1974, Congress passed the Employee Retirement Income Security Act, known as ERISA, in response to several large pension plan terminations that left tens of thousands of workers without retirement benefits. ERISA established comprehensive standards for pension plans. Employers generally were required to pre-fund pension plans over a 30 year period to ensure that the money needed to pay benefits in the future would be there.

ERISA has generally worked well. But in some ways, it has done too good a job. After fifteen years of good funding and the strong investment returns these funds have earned, the majority of pension plans today are very well-funded. Pension plans currently contain approximately $250 billion in assets for retirement liabilities that are not yet due.

Unfortunately, this pool of assets has created a great temptation for employers to terminate their pension plans and recapture those funds. Since 1983, 2000 employers have raided pension plans to recover $20 billion jeopardizing the retirement benefits of two million workers and retirees.

For the past six years, I have been trying to enact legislation to protect the retirement security of workers hurt by these terminations. In this Congress, I have introduced S. 685, the Employee Pension Protection Act, which protects workers' fair share of pension plan assets.

The key question is this debate has been—whose money is it in those pension plans? Employers argue that it is their money. Workers argue just as strongly that it belongs to them. After listening for years to both sides, I do not believe there is any clear answer. Both sides have legitimate interests in that money. But I also believe that legislation is needed to protect the interests of workers and retirees in "excess" pension plan assets

That brings me to the proposal to permit the transfer of assets from pension plans to retiree health benefits. Both ERISA and the Tax Code currently prohibit such transfers and our committees would have to agree to amend both to change the law. The issue has gained prominence in part because the Financial Accounting Stand-

ards Board has determined that these liabilities should be reported on corporate balance sheets. These developments have escalated the desire of employers to start funding retiree health benefits.

Up until now, Congress has given little consideration to the complex policy questions this proposal raises. Just like the termination and employer reversion issue, the transfer issue raises the same fundamental question—whose money is it in those pension plans? Should money set aside for workers' and retirees' pensions be used to pay for existing employer liabilities? Should we be balancing corporate books on the backs of retirees? I do not believe that Congress has sufficiently considered this proposal and therefore, I do not believe Congress should permit the transfer of pension plan assets from ongoing plans at this time.

But, I am a realist about the context in which this issue has arisen. I understand that the tax committees are under severe pressure to raise revenue and that a transfer proposal is very tempting because of the money it saves. The Ways and Means Committee has already approved a transfer as part of its budget reconciliation recommendations. I am willing to work with this committee on this issue. But, any change in the law must ensure that both the pension and retiree health needs of workers are protected.

Our committees must consider the termination issue as well. In 1987, as part of budget reconciliation, both our committees agreed, in conference, on a proposal to protect workers' pensions before employers could receive excess assets upon termination. Unfortunately, our agreement was deleted when we could not reach consensus on other issues. The termination issue has gone on far too long. To the extent that we are considering the use of pension plan assets on an ongoing basis, we also must resolve the termination issue. Even in the absence of an ongoing transfer, the termination problem still exists and must be remedied.

With respect to retiree health benefits, there are currently no standards for the provision of these benefits. We need some minimum standards to ensure that the retirees receiving these benefits are adequately protected.

In conclusion, I believe that the members of our committees must give very serious consideration to the issues at hand affecting both pension plans and retiree health benefits. Although I do not believe that pension assets should be transferred to retiree health benefits, I am willing to consider the issue. I believe most strongly that we must ensure that the pension benefits of workers are protected both on an ongoing and on a termination basis. Now is the time to finally resolve the termination and employer reversion issue. I stand ready to work with this Committee to ensure that the retirement needs of American workers are adequately protected.

Prepared Statement of Steven Schanes

The American Association of Retired Persons (AARP) is pleased to appear before this joint hearing of the Subcommittee on Private Retirement Plans and Oversight of the IRS and the Subcommittee on Taxation and Debt Management to testify on the important issue of employer-sponsored post-retirement health benefits (PRHB's), and in particular, on the use of pension assets to finance these benefits.

I. TRANSFERRING PENSION ASSETS FOR RETIREE HEALTH BENEFITS

A. Preserving the Long-Term Pension Promise

One source of financing employer-provided retiree health benefits that has recently surfaced is allowing access to the funding reserves built up in pension plans. In particular, some have recommended that defined benefit pension funds not needed to satisfy *current* obligations (or assets at some arbitrary percentage above amounts needed to satisfy *current* obligations) be available to pay for an employer's retiree health benefit obligations. AARP generally opposes these proposals, as they merely sacrifice necessary long-term pension funding objectives to meet retiree health benefit needs.

Under current law, an employer may not remove nor transfer funds from an *ongoing* pension plan. These funds, intended under the Employee Retirement Income Security Act (ERISA) for the "exclusive benefit" of plan participants, are necessary for the long-term retirement security of workers and retirees. In defined benefit plans in particular, the pension promise is most valuable when based on the employee's entire working years. Accordingly, under typical plan formulas, benefits accrue more rapidly in the later years (when both salary and years of service are highest) In order to meet this future need, companies are generally required to prefund their projected pension benefits in the early years. In essence, *all* plans that are funded on an actuarially sound basis have more assets than are needed to satis-

fy *current* pension obligations. While many refer to these plans as "overfunded," most of the so-called "surplus" assets are in fact necessary to meet future pension obligations.

Proposals to strip money from pension plans to meet retiree health liabilities—whether by asset transfers or plan terminations—threaten to undermine the stability of pension plans and the long-term nature of the pension promise. The end result may simply be that both the pension promise and the retiree health promise are jeopardized for future retirees.

AARP has long opposed the practice of plan termination to gain access to plan funds. Tax preferred money, intended to meet long-term pension obligations, should be used for that purpose. Proposals to simply shift pension assets to meet other needs, even worthy needs such as retiree health benefits, do nothing to avoid the same initial problem—that of undermining the pension promise, thus frustrating the very purpose for which the tax subsidy was originally intended.

Until the original pension promise can be *fully* secured—including adequate protections for both workers and retirees—the Association would oppose any transfer of pension assets for other purposes.

B. Securing the Pension Promise

The question that then arises is: What level of pension funding can fully secure the pension promise? The Association supports a pension funding level that is based on the *projected* benefit obligations of the plan, not a plan's *current* obligations. While assets sufficient to meet the current liability of a plan can assure that today's obligations are met, there is only limited protection for future liability. Using projected liability would help assure that funds are available at retirement to meet long-term pension obligations. The Association also recommends that a "cushion" of assets above projected benefit obligations be maintained in order to ensure against investment downturn and to provide for benefit adjustments to both workers and retirees.

Currently proposed legislation, the "Employee Pension Protection Act," S. 685, establishes this type of pension funding standard in the area of plan termination. Because both plan termination for reversion and plan asset transfer deal with pension plan security and preservation of the original pension promise, the limits in this bill are appropriate in dealing with the question of plan asset transfer. The level of permissible employer access to pension funds in this bill, while not the only possible alternative, is consistent with AARP's above statements on the need for adequate funding levels with appropriate asset "cushions."

Some have proposed a pension funding level for plan asset transfer based upon an arbitrary percentage above current liability. Because current liability ignores the long-term nature of the pension obligation, use of this standard by definition does not take into account long-term pension funding needs.

The 150 percent full funding limitation (FFL) is one example of such an arbitrary determination. The FFL, enacted in 1987, disallows deductible pension contributions for pension plans with assets above 150 percent of obligations currently owed on a termination basis. The main reason for enacting such a limit was to raise revenue. While the new FFL may be appropriate in some cases, it is inadequate to meet the funding needs of other plans. Instead of an arbitrary limitation, a plan-specific approach based on a plan's ongoing projected benefit obligations would better meet the long-term pension obligation. The Association therefore supports funding levels (or asset transfer levels) determined plan-by-plan, based on the ongoing funding needs of the individual plan (and the ongoing benefit expectations of plan participants) rather than arbitrary levels based on current liability.

Because the 150 percent FFL already is part of current law, it provides a convenient—albeit arbitrary and inadequate—level for additional discussions of plan funding needs and plan asset transfers. Indeed, two House Committees have recently acted to permit pension transfers based on the FFL. Again, the primary reason for such action is to raise revenue.

While the 150 percent FFL is inadequate for proper funding in many instances, allowing a transfer of pension assets below this level would not only provide less benefit protection in the long term, but would also simply allow an employer to game the tax subsidy. An employer could fund up to the 150 percent FFL (if not already over), then transfer down to a level less than the 150 percent FFL, and then again fund up to the 150 percent FFL. The House Committees, recognizing this possibility, generally chose levels to avoid such gaming of the tax system.

(The House Ways and Means Committee, while allowing a transfer down to 140 percent, also reduced the FFL for such transfer or companies to 140 percent. The committee also allowed for only a one-time transfer, required before January 1,

1992. This maximized the potential revenue gain. The House Education and Labor Committee, while permitting a transfer down to the 150 percent FFL, also added important protections for plan participants, including a prohibition on all other forms of pension reversions.)

C. Protections Needed In the Event of Asset Transfers

Since a level of assets may in some cases be present above levels necessary to ensure plan-specific projected benefits as outlined above, and since two House Committees have already indicated a willingness to permit plan asset transfers above the FFL, it is appropriate to discuss necessary protections in the event of plan asset transfers.

If tax-deferred assets are transferred or otherwise used for retiree health benefits, protections that pension participants enjoy under ERISA should also transfer. In particular, ERISA mandates certain vesting, coverage, and participation standards, as well as funding standards, to ensure that tax-subsidized assets are fairly distributed to benefit recipients, and that the recipient is certain of an earned and guaranteed benefit. It would be inappropriate to transfer money from a highly regulated, guaranteed pension system with basic employee protections to a non-regulated, unprotected, ill-defined retiree health benefit promise. In many instances, the assets may even transfer to a different set of beneficiaries. Therefore, if any asset transfer occurs, it should be accompanied by standards that ensure employee protections and guarantees.

Specifically, any proposal that allows for the transfer of pension assets for non-pension purposes, including retiree health, should also address the broader question of asset reversions. The Association has long supported restrictions on asset reversions upon plan termination. If the Committee chooses to allow employers tax-free access to pension money to meet retiree health needs, then the Committee should take the opportunity to prohibit access to pension funds for other purposes, including plan terminations for reversions.

Even if the Committee does not act on the question of asset transfers, the Association strongly urges this Committee to enact greater restrictions on plan terminations for reversions. Such restrictions are necessary to deter current law terminations for reversions which allow an employer access to pension funds. Since 1980, about $20 billion affecting over 2 million workers and retirees has essentially been "transferred" out of pension funds—on a taxable basis upon plan termination—thus undermining the long-term pension promise.

In addition to maintaining the ongoing funding level and the integrity of the pension plan as discussed above, any funds transferred to a retiree health account should include basic protections. First, the class of retirees receiving benefits should be participants of the original pension plan. This would be more consistent with ERISA's exclusive benefit rule. Second, any money transferred for retiree benefits should be non-revertible to the employer. Third, all participants of the original transferor pension plan should be immediately vested in their pension benefits, with proper notice given to all parties affected by the transaction.

In order to more fully protect retirees upon granting a tax-free transfer to employers, the retiree should be guaranteed the level of retiree health benefits existing at the time of the transfer. This should also include a short look-back period to prevent abuse by an employer who could otherwise make benefit cuts prior to a transfer. While the Association would recommend a lifetime guarantee of benefit levels, a shorter period may be considered depending on the type of transfer permitted.

II. PRE-FUNDING PRHB'S

A. The Need for Federal Incentives with Standards

The question of pension asset transfers for retiree health also raises the basic question of whether or not to provide tax incentives to pre-fund retiree health benefits. Allowing pension asset transfers above a certain limit in essence allows *some* companies to use tax-favored dollars for retiree health benefits, but not others. This "solution" for some companies clearly avoids dealing with the basic questions surrounding the long-term PRHB promise, and does nothing to help those employers with retiree health plan liabilities not in a position to transfer pension funds. In addition, this "solution" for retiree health is short-term, and may only result in problems in pension funding and meeting the long-term pension obligation—a result which should be avoided.

The Association supports tax-subsidized pre-funding for PRHB's to ensure that money is there when the retiree needs it. Of course, encouraging pre-funding will have a cost to the Treasury. If funds are available, tax benefits for PRHB's, since

they are likely to benefit those who already have better retirement income packages, should be balanced with improvements in government health programs.

In addition, tax advantages for PRHB's *necessitate* that appropriate standards for funding, vesting and participation be enacted in order to ensure proper allocation of the tax benefit. If tax funds are used to pay a portion of the benefits, we must ensure these benefits are guaranteed and distributed fairly.

While employers desire a more *definable obligation*, a balance must be reached regarding employer commitment and benefit adequacy. One emerging trend, largely the result of less predictable (and rapidly rising) health costs, is the shift by employers towards defined contribution promises (cash benefits) and away from defined benefit promises (health services) This is a disturbing trend because the retiree is not as well protected under a defined contribution-type plan, since cash benefits (which are also taxable) will not keep pace with health care inflation.

Retirees also desire benefit certainty. The employee is unable to adequately plan for retirement unless there is an *enforceable guaranteed promise*. While there may be a promise of benefits, as well as the money to finance them, there is no guarantee of receiving PRHB's unless standards are established to ensure employees may earn the right to receive the benefit.

B. Section 401(h) and the 150 Percent FFL

An example of the tension between pension and retiree health benefits is exemplified by the recent IRS position on Section 401(h) plans and the 150 percent FFL. As stated above, AARP believes the FFL is contrary to good pension policy, since it does not necessarily allow for the proper funding of pension plans. Most employers and their representatives have agreed, stating the 150 percent level is inadequate to meet long-term pension needs. (The Association notes the inherent inconsistency of those who believe *150 percent* of termination liability is a level insufficient to properly fund for long-term pension benefit security, yet who also believe that removing pension assets down to levels as low as *125 percent* of termination liability for transfer to retiree health plans does not jeopardize pension benefit security.)

Contributions to Section 401(h) health plans, which are subordinate to pension plans, are limited by the contributions for pension benefits. The FFL, which limits pension contributions, apparently does not, according to the IRS, apply correspondingly to 401(h) plans. In essence, a limit on the proper long-term funding of pension plans can be circumvented by contributions to 401(h) plans. (The Association notes that the House Ways and Means Committee, in their recent asset transfer proposal, has also overruled the IRS position.) Since AARP believes the FFL is not good pension policy, circumventing the FFL for health benefit needs may not be a bad result. However, it is important to recognize what this policy is—a limit on pension funding and an expansion of retiree health funding. Both long-term pension obligations and retiree health commitments should be made secure. If Congress wishes to allow for pre-funding of retiree health benefits, it should do so for all companies. Congress should not, however, choose to fund retiree health benefits by endangering the pension funding status of some pension plans.

III. CONCLUSION

PRHB's fulfill an important role for a significant segment of the American population. Employer incentives, with appropriate employee standards and protections, are therefore necessary to ensure the continued survivability of PRHB's as a valuable component in the retirement income framework.

Alternative ideas for paying for PRHB's, such as the transfer of pension assets, do little to address the underlying issues for the future of PRHB's and may simply undermine long-term pension obligations. Congress should focus it attention on the broader problems posed by plan terminations for reversions and the larger questions posed by employer-provided retiree health benefits, and avoid quick-fix solutions that may adversely affect the pension promise. Otherwise, millions of Americans could continue to suffer the consequences of a health need that is unmet, and a benefit promise that is broken.

The Association looks forward to continued work with this committee on the issues of asset reversion and employer-provided health benefits, and retirement income policy in general. Ongoing discussions should lead to action that will create a more secure retirement for older Americans.

PREPARED STATEMENT OF JOHN E. STAIR, JR.

Chairmen Pryor and Matsunaga and distinguished members of the Subcommittees, my name is John E. Stair, Jr. I am a manager in the Employee Compensation and Benefits Division of the Du Pont Company, a diversified chemical and energy company. Today, I am testifying on behalf of the Coalition for Retirement Income Security (CRIS).

CRIS is an ad hoc group of large corporate sponsors of soundly funded pension plans that also provide health care benefits to their retired employees. Members include representatives of a variety of industries including telecommunications, computers, chemicals, oil and manufacturing. We are committed to encouraging measures that promote the retirement benefits security of the millions of current and future retirees who have dedicated many years to the service of their companies. Proof of our commitment is the well funded status of our pension plans. We commend the Subcommittees for conducting hearings on the important subject of employer-sponsored retiree health benefits and thank you for inviting us to testify. We also wish to applaud Senator Pryor's legislative efforts in this area.

Retirement benefit security is emerging as a critically important issue with implications for decades to come. Several developments have played major roles in pushing this issue to the top of our priority list. Two of the most visible developments are spiraling health care inflation and the aging of the population; both have fueled the dramatic increase in the cost of providing health care benefits to our retirees. A third development is the Financial Accounting Standards Board (FASB) proposed accounting standard which spotlights the economic and demographic developments and places new requirements on the financial reporting of companies that sponsor retiree health care.

CRIS member companies are committed to providing retiree health benefits and believe enhancing the security of those benefits is dependent upon prefunding. Moving to prefunding is a two step process. One step would permit the transfer of excess pension fund assets into a 401(h) account within the pension plan or into a retiree medical trust. The second longer term step would be to provide companies with incentives to prefund for retirement health benefits.

We believe we can be most helpful to this Committee by addressing the first step which is the essence of the CRIS proposal. The proposal also is in keeping with our view that the Federal government can promote benefit security most effectively by assuming the crucial role of facilitator. The balance of my testimony will outline the CRIS proposal.

To begin, the CRIS proposal is a limited one which deals solely with the transfer of excess pension fund assets to secure the health benefits of current retirees. It does not address the broader issues of general prefunding of retiree health benefits and the implications that could have for benefit security. The key features of the proposal are as follows:

1. Excess pension assets should be available for voluntary transfer to a 401(h) account within the pension plan or a retiree medical trust ("RMT") to pay health plan benefits for retirees. The amount eligible to be transferred, the transferable pension surplus, would be the difference between the lesser of market or actuarial value of assets in the pension plan and the lesser of the following two values:

   a. 100% of "actuarial accrued liability" plus normal cost as of the latest valuation (including the effects of future pay increases) or,

   b. 125% of "current" liability where current liability is defined as the liability used for full funding purposes.

2. Any such transfer would be differentiated from a termination/reversion in that it would be free of income, excise, or any other tax and would not force vesting or annuitization of pension liabilities for active or retired employees.

3. Income earned on assets in the 401(h) account or the RMT would remain free of income tax or unrelated business income tax.

4. Transferable assets would be limited to the amount of eligible retiree health liability—including a provision for medical care cost trend and medical inflation—for current retirees at the date of transfer.

   a. The eligible group includes all retirees who have health care coverage at company expense.

   b. Valuation should be on a closed group basis, using each company's best estimate of health care cost trend and medical inflation.

5. The initial transfer would be permitted at any time at the employer's discretion as long as the conditions for transfer are met on that date. A maximum of three transfers would be permitted in a ten year period.

6. To protect the revenue impact, transferred money should be required to be "first payor" with respect to employer obligations for retiree health benefit payments. Guarantees require that transferred assets are dedicated exclusively to provide retiree benefits. Guarantees offered are provided on an aggregate basis to eligible retirees and not through separate accounts.

7. Recoverable pension surplus cannot be used to provide retiree health benefits for retirees other than those who were participants in the transferor plan except as provided in #9 below. Transfers to the 401(h) account or RMT (and any amendment to a pension plan to provide for such) for the benefit of such participants shall not be considered a violation of the exclusive benefit rules under ERISA or any involved pension plan.

8. Transfers should be reflected as plan amendments for the purposes of minimum and maximum pension funding rules.

9. In the event of a certified actuarial surplus, the eligible group may be enlarged to include new current retirees. After satisfaction of all liabilities under the plan(s), excess assets in the RMT or 401(h) account shall revert back to the pension plan or fund from which the assets were drawn.

10. Other ERISA requirements such as coverage, nondiscrimination, vesting or minimum funding do not apply to the RMT.

11. The 401(h) account or RMT will cover participants of at least one or more health plans which will provide benefits in accordance with those plans for the eligible group and not a select group of the employer's choice.

12. The 401(h) account or RMT will be permitted to provide different levels of retiree health benefits according to the provisions of the health care plan(s).

13. The 401(h) account or RMT is separate and distinct such that its tax exempt status is not impacted by the application of the Section 89 nondiscrimination testing to the underlying plans.

The CRIS proposal provides advantages to retirees, employers, and the government as follows:

Our proposal enhances benefit security by dedicating assets for retirement income security in several ways. With funds set aside in a dedicated trust, the future of retiree health care benefits would not be dependent upon the economic health of the plan sponsor. The assets would be earmarked solely to provide retiree health benefits. As such, those assets would be immune from the claims of creditors and would not be available for non-benefit corporate purposes. Retirees would receive enhanced security in an era of corporate takeovers both through the dedication of transferred assets solely toward retiree medical benefits and through the reduction of surplus pension assets that often encourage takeovers. Pension benefit security remains intact by limiting the amount eligible to be transferred. Finally, the transferable pension surplus could only be used to provide retiree medical benefits for retirees who were participants in the transferor plan.

Employers would benefit from increased cash flow as benefits would no longer be paid from operating assets, thereby stimulating investment and enhancing U.S. competitiveness.

The CRIS proposal in the form I have previously outlined would also significantly increase tax revenues because transferred assets would be the source of retiree benefit payments. Thus, employers, to the extent the transferred assets are sufficient to cover retiree health benefits, would not continue to take tax deductions for those payments. The Joint Committee on Taxation's estimate of the revenue impact of the proposal shows that tax revenues would increase by approximately $3.2 billion over the 1988–1992 fiscal years if the CRIS proposal applied throughout that period.

Without question, the revenue increase to be gained from this proposal is highly dependent upon the extent to which companies with excess pension assets are persuaded to use that source of funds, rather than deductible operating assets, to pay for retiree health care costs. The Subcommittees should be aware that the modifications to the CRIS proposal which have been included in the actions to date before the Ways and Means Committee would substantially reduce or eliminate expected utilization. Indeed, the retiree health provision in the pending Ways and Means document bears little resemblance to the proposal of the CRIS Group. As a consequence, virtually no revenue benefit will result should the Finance Committee follow a similar path. In particular, the Ways and Means mark requires that all plan participants be fully vested in accrued pension benefits and that all pension plan benefits be annuitized, i.e., that assets equal to the termination liability be invested in annuity contracts.

It is our understanding that the vesting and annuitization requirements were added to protect the security of promised pension plan benefits. While such goals are laudable, such restrictions are unnecessary with respect to this proposal since the pension promise remains intact and is protected with assets equal to 125% of its value.

Historically, such restrictions have been found appropriate where a pension plan was terminated, or where the sponsoring employer received a reversion of assets in excess of pension liability and used such assets for non-benefit purposes. Such termination and reversion situations are clearly distinguishable from a retiree health transfer proposal which provides significant benefit protections for plan participants.

The transfer proposal does not involve a plan termination or reversion. Thus, pension benefits (and participants' vested rights to such benefits) will continue to increase over periods of continued service. Moreover, the proposal requires that any transferable amounts be used *exclusively* to provide retiree health benefits for the same group of participants on whose behalf such assets have been accumulated.

As corporate initiators of the retiree health transfer proposals, we feel obliged to note that, absent the deletion of the vesting and annuitization rules found in the Ways and Means mark, it is extremely unlikely that the proposal will be implemented. In fact, our analysis indicates the present value of the lost pension earnings caused by the annuitization condition will exceed the actual amount that can be transferred. These lost earnings will necessitate increased future pension contributions. Thus, in reality, the Ways and Means annuitization requirement results in the transfer proposal having an adverse impact on corporate financial statements as well as the Federal treasury.

The unworkability of the pending Ways and Means document can best be illustrated by an example:

Assume:

- Total pension assets equal $200 million.
- Pension termination liability equals $125 million.
- Annual retiree health expenses equal $5 million.

The proposal included in the Ways and Means mark would restrict the retiree health transfer to $10 million (two years of retiree health expenses). Moreover, to gain this mere $10 million cash flow advantage the employer would be required to vest and annuitize $125 million of pension liability.

The Joint Committee on Taxation (JCT) originally estimated that the transfer proposal, without vesting and annuitization, would raise $300–500 million in FY90 and $500–800 million in FY91 (with cushions ranging from 150 to 125%). JCT presently estimates that the proposal, modified as noted above by Ways and Means, coupled with the addition of further restrictions on section 401(h) accounts, will raise $286 million in 1990 and $465 million in 1991. It is not clear what assumptions about the expected utilization of the transfer proposal the JCT used to arrive at these figures. The CRIS Coalition strongly believes that little or no revenue will be gained because employers will not elect to implement the vesting and annuitization that are required.

We also point out to the Subcommittees that the Ways and Means mark differs from the CRIS proposal in other material respects. First, the Ways and Means version limits transferable amounts to two years of anticipated retiree health costs, a time period which does little to enhance benefit security. The CRIS proposal, as discussed above, would permit transfer of a much larger amount, i.e. the present value of anticipated lifetime costs. Second, Ways and Means would require maintenance of a pension plan cushion equal to 140% of current liability for pension benefits. The 140% restriction would last for five years while the transfer authorization expires after two years. CRIS advocates a cushion of 125%—an amount which the Department of Labor has found adequate for purposes of pension fund security.

To conclude, the Coalition's proposal represents an important first step toward the goal of providing benefit security for retirees. It also is advantageous to employers who have responsibly funded their retiree pension benefits because it improves their cash flow. As originally offered by CRIS, our proposal is also advantageous to the country because it raises tax revenues. However, as mentioned above, the desired new revenue will quickly evaporate if restrictions such as those currently suggested by the Ways and Means Committee are added.

In closing, we thank the Subcommittees for this opportunity to present the CRIS proposal and will be pleased to address any questions or comments you may have.

Attachments.

CRIS
Coalition for Retirement Income Security

Suite 1000
1120 20th St., N.W.
Washington, D.C. 20036
(202) 457-3838

ATTACHMENT I

August 1, 1989

The Coalition for Retirement Income Security is an ad hoc coalition of companies with well funded pension plans. Some of the participating companies include:

Ameritech	GTE
AT&T	Household International
Bell Atlantic	IBM
Bellcore	Kodak
BellSouth	3M
Chevron	NYNEX
DuPont	Pacific Telesis
Engelhard Industries	Shell Oil
Florida Power & Light	Southwestern Bell
Ford	W. R. Grace
General Electric	

ATTACHMENT II

Excess Pension Assets and Current Retiree Health Liability of Selected CRIS Participants

($ millions)

	Termination Liability, 1987	Fair Market Value of Assets, 1987	Excess Pension Assets, 1987	Current Retiree Health Liability, 1987
Plan 1	6,360	10,691	4,330	-
Plan 2	295	463	168	-
Plan 3	3,110	5,377	2,267	-
Plan 4	2,469	4,108	1,640	-
Plan 5	3,260	4,865	1,605	-
Plan 6	3,600	8,940	5,340	-
Plan 7	7,354	14,541	7,187	-
Plan 8	6,868	13,112	6,244	-
Plan 9	2,195	3,047	852	-
Plan 10	374	570	196	-
Plan 11	9,350	19,050	9,700	-
Plan 12	1,990	3,230	1,240	-
Plan 13	1,680	2,660	980	-
Plan 14	2,661	3,597	936	-
Plan 15	2,403	4,165	1,762	-
Plan 16	2,769	4,253	1,484	-
Plan 17	371	458	87	-
Plan 18	117	191	74	-
Plan 19	2,820	4,910	2,091	-
Plan 20	4,002	6,016	2,013	-
Plan 21	244	584	340	-
Plan 22	10,194	17,574	7,380	-
Plan 23	1,741	2,126	385	-
Plan 24	2,283	3,138	855	-
TOTAL	78,511	127,688	49,177	10,258

Source: Price Waterhouse
Date: August 11, 1989

Washington National Tax Services
Suite 700
1801 K Street, N.W.
Washington, DC 20006
Telephone 202 296 0800

ATTACHMENT III

Price Waterhouse

THE REVENUE EFFECT OF THE ADDITIONAL CASH FLOW TO EMPLOYERS DUE TO THE CRIS RETIREE HEALTH TAX PROPOSAL

The CRIS proposal on retiree health costs would permit a limited transfer of excess pension fund assets to fund the benefits of current retirees. The benefit to employers of this proposal is the additional cash flow resulting from retiree health costs being paid out of these excess pension funds rather than by out-of-pocket cash. A question that has been raised is whether this additional cash flow to the employers produces a tax revenue effect that should be incorporated in the revenue estimate for the CRIS proposal. The answer to this question is "no".

Pension funds supply their assets to the economy through the investments they make. The additional cash flow to employers due to the CRIS proposal is provided by a transfer of excess assets out of pension funds. Thus, any net increase in funds available to the employers is matched by a net decrease in funds available to other sectors of the economy through the reduced supply of funds provided by pension funds.

This zero change in total funds available will result in no change in total tax revenues if (1) the tax status of those receiving the net increase in funds is, on average, the same as the tax status of the those experiencing the net decrease in funds, and (2) if both groups use the funds in the same manner. Current economic models are not capable of accurately projecting exactly which taxpayers will experience the increases and decreases in funds. Lacking any better information to the contrary, the most justifiable assumption is that those receiving an increase in funds have the same tax status and use the funds

in the same manner, on average, as those experiencing a decrease in funds.

Revenue estimates made for tax policy purposes generally incorporate assumptions regarding the effect of the proposal being estimated on the overall economy. Such assumptions are necessary and, we believe, are in most cases justifiable on theoretical or practical grounds. One such assumptions that is seldom violated in revenue estimates is that GNP is unchanged by the tax proposal.

The assumption that GNP is unaffected by the proposal implies that the distribution of funds in the economy has no impact on overall levels of income. With no change in total incomes, and no effect on taxes due to a change in the distribution of funds, the additional cash flow generated for employers by the CRIS proposal can have no tax revenue consequences.

For example, assume the CRIS proposal increases cash flow to Company X by $1 million, and that Company X invests this additional cash flow in the business. The pension fund from which the $1 million of excess assets were transferred now has $1 million less to invest. This means that $1 million less in funds is available to other companies. The change in Company X's taxes due to the additional $1 million will be exactly offset by the change in the taxes of the companies that lose the $1 million. Thus, the additional cash flow to Company X does not change total tax revenues of the U.S. Treasury.

ATTACHMENT IV

LEGAL ENVIRONMENT AND STANDARDS

THEORIES UNDERLYING EMPLOYER OBLIGATION TO CONTINUE BENEFITS

- o VESTING: EMPLOYEES DO NOT "VEST" IN WELFARE BENEFITS
  - Although parties may contract for postretirement medical benefits, employees do not vest under ERISA in such welfare benefits. Court distinguished between pension and welfare benefits for vesting purposes.

    HANSEN v. WHITE FARM EQUIPMENT CO., 788 F.2d 1186 (6th Cir. 1986).

- o REPRESENTATIONS: HAS EMPLOYER CLEARLY RESERVED RIGHT TO MODIFY AND/OR TERMINATE BENEFITS
  - Employer clearly reserved right in governing documents to modify terms of medical benefits, and was permitted to increase deductible amounts, even though employer informally indicated in company newspapers, letters, etc. that retirees would receive "lifetime" benefits "at no cost".

    MOORE v. METROPOLITAN LIFE INSURANCE CO., 856 F.2d 488 (2d Cir. 1988).

  - Similarly, employer permitted to increase retiree health premiums since plan did not limit retiree contributions nor promise to continue benefits, and reserved employer's right to terminate benefits.

    PETERSON v. GRAND TRUNK WESTERN RAILROAD CO., 683 F. Supp. 649 (E.D. Mich. 1988).

  - Employer was permitted to change retiree medical insurance plan from noncontributory to contributory for retirees age 65 and older and also to increase level of contributions for early retirees (before age 65) since the insurance policy provided that employer could amend or terminate the medical coverage at any time. Court also found that medical benefits do not vest at retirement, and employer never promised to always pay insurance premiums for retirees.

    MUSTO v. AMERICAN GENERAL CORP., 861 F.2d 897 (6th Cir. 1988).

- Since employer had not explicitly reserved the right to modify or terminate benefits and represented that employees would receive benefits for life, employer was obligated to continue benefits for retirees.

  EARDMAN v. BETHLEHEM STEEL CORP.,
  607 F. Supp. 196 (W.D.N.Y. 1984).

o CONTRACTS: ARE BENEFITS CLEARLY LIMITED TO DURATION OF CONTRACT

- Medical benefits which were clearly limited to duration of collective bargaining agreement may be reduced or discontinued by employer upon expiration of collective bargaining agreement.

  BOX v. COALITE,
  643 F. Supp. 709 (N.D. Ala. 1986).

- However, if benefits are not clearly limited to contract duration, then employer may be obligated to continue level/type of benefits. Such a determination will be based on a review of relevant extrinsic evidence (i.e., employer communications, SPD's, exit interviews).

  UAW v. YARD-MAN, INC.,
  716 F. 2d 1476 (6th Cir. 1983).

o "STATUS" BENEFITS: ENTITLEMENTS NONFORFEITABLE ONCE RETIREMENT STATUS ACHIEVED AND MAINTAINED

- Employer was obligated to continue benefits to retirees, even after expiration of bargaining agreement, since contract implied that benefits would continue while retirees remained retired.

  UNITED STEELWORKERS v. CONNORS STEEL CO.,
  855 F.2d 1499 (11th Cir. 1988).

- Employer could not terminate bargained-for retiree benefits pursuant to a plant closing agreement which attempted to cease benefits since benefits were status benefits and contract did not limit benefit duration.

  UNITED PAPER WORKERS INTERNATIONAL UNION v. MUSKEOGON PAPER BOX COMPANY,
  No. G87-295 CA, 1988 U.S. Dist. Lexis 15526
  (W.D. Mich. 1988).

PREPARED STATEMENT OF DANA L. TRIER

Mr. Chairmen and Members of the Subcommittees: I am pleased to appear before you to discuss the views of the Department of the Treasury regarding the current proposals being considered by Congress concerning employer-provided retiree health benefits and employee stock ownership plans. The first portion of my testimony will review the retiree health proposals the Subcommittees have asked us to address and will include: (1) a description of the factual background against which the proposals arise; (2) a review of the tax incentives available to employers to fund retiree health benefits under current law; (3) a brief summary of the proposals; and (4) the views of the Department of the Treasury regarding the provision of additional tax incentives beyond those already provided under current law. Proposed changes in tax treatment of employee stock ownership plans will be addressed in the second portion of my testimony.

PART I. RETIREE HEALTH BENEFITS

Background

Some employers maintain plans to provide retiree health benefits to their current and future retirees. The liability the plans represent to individual employers depends upon a number of factors, including: (1) the type and level of benefits promised; (2) the employer's ability legally and practically to modify or terminate the benefits; and (3) future health care cost inflation. Although the Department of the Treasury has not compiled independent data on the overall magnitude of the liabilities, it is reasonable to believe they are substantial.

A significant share of the liabilities relate to retiree health benefits promised to those who retire before age 65. Such early retiree health benefit liabilities are particularly significant on a present value basis because the benefits are paid out at an earlier point in time and the employer-provided portion of benefits paid after age 65 shrinks substantially when most retirees become eligible for Medicare coverage from the Federal Government. As an indication of the relative magnitude of early retiree health benefits, data gathered by the General Accounting Office suggest that of the $8.6 billion in retiree health benefits paid out by employers in 1988, fully 56 percent went to pay for early retiree health benefits.

Publicly traded companies subject to financial reporting requirements under the federal securities laws and other companies that provide certified financial statements to third parties may be required in the future to disclose the amount of their retiree health benefit liabilities. The Financial Accounting Standards Board ("FASB") has proposed to require such disclosure for fiscal years beginning after December 15, 1991, subject to certain transition rules. The proposed FASB standards would not create any new retiree health benefit liabilities, but rather would require employers to disclose the amount of their already existing liabilities on their financial statements.

Current Tax Incentives

Current law provides two arrangements through which an employer may prefund retiree health benefits on a tax-favored basis. The first of these two arrangements is the so-called 401(h) account, which an employer may maintain in conjunction with qualified pension and annuity plans. Contributions made to a 401(h) account are currently deductible by the employer, and income earned in the account accumulates on a tax-free basis.

Section 401(h) of the Internal Revenue Code provides for this tax-favored treatment only if the retiree health benefits are "subordinate" to the pension benefits provided under the plan. In general, the regulations provide that the health benefits will be considered subordinate if the cumulative contributions to a 401(h) account at any point in time do not exceed 25 percent of the total cumulative contributions made to the plan since the 401(h) benefit was first added to the plan. In a series of recent private letter rulings, the IRS has expanded the situations in which 401(h) retiree health benefits will be considered to meet the subordinate standard, essentially permitting contributions to a 401(h) account despite a plan's fully funded status at the time the 401(h) account feature is added.

The second arrangement under current law that permits prefunding retiree health benefits on a tax-favored basis is the special reserve for retiree medical benefits permitted under a welfare benefit fund such as a voluntary employee beneficiary association ("VEBA"). Under this arrangement, employer contributions are currently deductible, but income earned in the fund is subject to current taxation. In addition, contributions to prefund retiree health benefits must be calculated on the basis of current costs, and thus may not take into account future health cost infla-

tion. Congress prescribed the current level of tax incentives available for prefunding retiree health benefits under a welfare benefit fund in the Deficit Reduction Act of 1984. Prior to that Act, income on funds set aside in a VEBA to provide retiree health benefits could accumulate on a tax-free basis. The effect of this change was to limit full tax-favored treatment to 401(h) accounts, where retiree health benefits are preconditioned on the employer's provision of proportionately greater regular pension benefits.

Description of Proposals

The Subcommittees have asked for the views of the Department of the Treasury on three of the proposals currently under consideration in the Congress concerning the tax treatment of employer-provided retiree health benefits: (1) a private proposal advanced by the Coalition for Retirement Income Security ("CRIS"); (2) Senator Pryor's bill, S. 812; and (3) the proposal included in the revenue reconciliation bill pending in the House Ways and Means Committee. A brief description of each of these proposals follows.

The CRIS Proposal. CRIS, a private group of large corporate sponsors of overfunded pension plans, has circulated a proposal to permit intermittent transfers of excess pension assets to a retiree medical trust. Excess assets are defined as the excess of the value of plan assets (determined as the lesser of market or actuarial value) over the lesser of: (1) 125 percent of current liability; or (2) 100 percent of "actuarial accrued liability" plus normal cost as of the latest valuation (taking into account future pay increases). The transfer would be free of income and excise taxes, would not trigger vesting or annuitization of accrued benefits for participants in the transferor plan, and would be permitted to provide for the payment of retiree health benefits to persons other than participants and former participants in the transferor plan. The amount of the transfer would be limited to the cost of funding all future retiree health benefits for every former employee of the employer who is entitled to such benefits and who has retired as of the date of transfer, taking into account future health care cost trends and medical inflation. A maximum of three transfers would be permitted within a 10-year period.

The retiree medical trust would be free of income tax, but would not, it appears, be subject to any requirements regarding coverage, nondiscrimination, vesting, or minimum funding, including any of the requirements applicable under current law to 401(h) accounts or welfare benefit funds such as a VEBA. No deductions would be allowed the employer with respect to benefits intended to be paid out of the retiree medical trust, and excess assets remaining after the satisfaction of all trust liabilities would revert back to the transferor retirement plan.

The Joint Committee on Taxation has scored the CRIS proposal as raising $3.2 billion over the five-year budget period, with $500 million falling in 1990, $800 million in 1991, $700 million in 1992, and $600 million in each of 1993 and 1994. Treasury's own revenue estimates show the CRIS proposal raising $2.3 billion over the five-year period, with $400 million in 1990, $650 million in 1991, $525 million in 1992, $400 million in 1993, and $350 million in 1994.

The Pryor Bill. Senator Pryor's bill (S. 812) parallels an identical bill (H.R. 1865) introduced in the House of Representatives by Rep. Chandler and others on April 13, 1989. The bill would expand the present law rules governing the use and funding of 401(h) accounts. For the first time, these accounts would be permitted to provide retirees with long-term care benefits in addition to medical benefits which are already permitted under present law. The bill would require up to two separate accounts for each covered employee, i.e., one each for long-term care benefits and medical benefits.

The funding rules applicable to 401(h) accounts would also be revised and no longer would limit the amount of 401(h) contributions to a portion of the regular pension contributions going into the plan. Instead, in the case of a defined benefit plan, the employer could make annual contributions up to an amount actuarially determined to be necessary to fund an annual retirement benefit of $2,500 for long-term care and $2,500 for medical benefits. Under the bill, it is unclear whether funding would be allowed under actuarial methods that permit faster than level funding or that assume retirement will commence before age 65. In the case of a defined contribution plan, annual employer contributions would be limited to $825 for long-term care benefits and $825 for medical benefits. These funding limitations would be indexed. In addition, the bill would permit employees to make salary reduction contributions to either or both of their 401(h) accounts.

The second portion of the bill permits an employer to transfer certain excess assets from an ongoing defined benefit plan to a 401(h) account, generally without income or excise tax consequences, as long as certain procedures are followed and

transfers occur no more frequently than once every five years. Excess assets are defined as those in excess of 125 percent of current pension liabilities at the time of transfer. The bill does not specify how transferred assets are to be allocated among the individual employee accounts created under the bill or with respect to any preexisting 401(h) accounts that might have been created under the provisions of present law. We understand that no revenue estimates have been prepared by the Joint Committee on Taxation at this time, and the Treasury Department also has not prepared complete revenue estimates.

The Ways and Means Proposal. The revenue reconciliation bill pending in the House Ways and Means Committee would permit an employer to make a one-time transfer during 1990–91 of certain excess assets from an ongoing defined benefit plan to a 401(h) account. The transfer would be limited to the lesser of: (1) assets in excess of the full funding limitation (using 140 percent of current liability instead of 150 percent); or (2) the total amount of retiree health benefits estimated to be paid or incurred by the employer during the employer's 1990 and 1991 tax years. The transfer generally would be free of income and excise taxes, except to the extent the transfer amount is not actually used to pay the estimated retiree health benefits. No deduction would be permitted the employer for payments or contributions with respect to benefits that may be funded out of the transferred assets. Full vesting and annuitization would be required for accrued benefits of participants in the transferor retirement plan, but payment of retiree health benefits out of the transferred assets would not be limited to participants or former participants in the plan. In addition, the transferor plan would be subject to a reduced full funding limitation during the plan year of the transfer and for four succeeding plan years.

In a separate provision, the House Ways and Means proposal would reverse the Internal Revenue Service's position taken in recent IRS private letter rulings permitting 401(h) contributions to a fully funded pension plan.

The Joint Committee on Taxation has scored the House Ways and Means proposal as raising $930 million over the five-year budget period, with $286 million falling in 1990, $465 million in 1991, $176 million in 1992, and no significant revenues in 1993–94. Treasury's estimate of the projected revenue gain is $665 million over the five-year budget period, with $172 million in 1990, $348 million in 1991, $144 million in 1992, and no significant revenues in 1993–94. No revenue estimates have been prepared by either the Joint Committee on Taxation or the Treasury Department on the separate provision reversing the IRS private letter rulings.

Additional General Tax Incentives for Retiree Health Coverage

The first question which we will address is whether it is appropriate to provide new general tax incentives for the prefunding of retiree health at this time. As described above, such incentives would be provided under Senator Pryor's bill, S. 812, as well as incentives for the prefunding of long term care.

All of us are concerned that the health care needs of retirees be met both now and in the future. Moreover, we understand that much of employers' current interest in retiree health benefits is a result of the FASB proposal to change the financial accounting rules for retiree health liabilities. It is the view of the Department of the Treasury, however, that the question whether additional general tax incentives should be provided for employer-provided retiree health benefits should be the subject of careful consideration and thorough debate prior to enactment of any new such incentive.

Perhaps the fundamental issues to consider are whether employer-sponsored retiree health plans should be provided additional tax incentives, and whether, assuming limited government resources, these tax benefits should be provided in a manner that is available to all individual retirees, regardless of their employer. The existing incentives available to employers are substantial. For example, section 401(h) essentially grants the employer a current deduction for an addition to a reserve for a future contingent liability, the payment of which will be excluded from the beneficiary's gross income. Such treatment, in combination with tax-free inside buildup, is almost without parallel in the tax law.

Thus, this treatment should only be extended under conditions that minimize the potential for tax abuse and maximize the likelihood the promised benefits will be provided in an equitable and efficient manner. But although the employer-sponsored system has expanded health and retirement coverages substantially, it is still the minority of employees that receive such benefits. For that reason, we are skeptical that increased tax incentives for employer-provided health benefits represent the optimal approach to the problem of funding retiree health costs.

Assuming that a decision is made to provide additional tax incentives for providing such benefits, a second important issue is the type of benefit promise that might

receive tax-favored treatment. One question is whether the tax system should encourage the promise of: (1) a defined health benefit such as indemnity insurance or membership in an HMO; (2) a defined dollar benefit intended to meet projected costs of retiree health coverage; or (3) a defined contribution benefit under which the employer obligates itself only to make specific contributions to an account dedicated to the provision of retiree health coverage. Each approach has its own advantages and disadvantages.

The defined health benefit approach may provide employees with some protection from health care inflation that the defined dollar and defined contribution approaches do not. At the same time, a defined dollar or defined contribution approach can offer an important degree of flexibility and individual choice that a defined health benefit approach may lack. For example, a defined dollar or defined contribution approach could be structured to permit individual retirees to exercise individual choice in meeting their retirement needs. Some retirees might prefer to purchase long-term care insurance rather than be provided with additional health insurance. Other alternative health care needs and programs may evolve in the future, and we should be careful that the tax system not create artificial preferences among alternative modes of health care.

The timing of the retiree health benefit is also a significant issue. We oppose proposals that would grant any additional tax incentives for retiree health benefits to be paid out before age 65. Provision of such early retiree health benefits tends to spend down overall savings that might better be reserved for later years when earning capacity is more likely to be reduced. We believe it is inappropriate for the tax system to provide additional tax incentives for such early retirement benefits at this time.

A third issue is what role the Federal Government should play in increasing the security of the retiree health benefit promises made by employers. As the members of the Subcommittees are no doubt aware, current law provides few protections to employees with regard to the retiree health care promises made by their employers. Minimum standards regarding participation, accrual, vesting, and funding that apply to qualified pension plans under ERISA and the Code do not apply to retiree health benefits promised by employers. It is the position of the Treasury Department that similar minimum standards are a necessary precondition to any additional general tax incentives for employer prefunding of retiree health benefits. Such standards may be very difficult to construct, particularly if applied to a defined benefit type retiree health plan, and should be carefully considered before the tax system is forced to absorb the additional regulation and complexity the implementation of such standards would entail.

An additional concern is the effect that increases in employer-provided retiree health benefits will have on health care cost inflation and thus on health costs borne by retirees and others who do not have these benefits. Health care inflation also raises costs for federal health care programs, such as Medicare.

We believe these issues are important ones and should be treated comprehensively after substantial analysis and debate. For that reason, we cannot support the basic additional incentives provided in the Pryor bill.

Excess Asset Transfers

Most of these general points regarding tax incentives for the provision of retiree health also apply to the various specific proposals to permit transfers of excess pension assets to fund retiree health benefits. The principal difference is that, at least in the short term, the revenue consequence may not be the granting of new federal tax expenditure subsidies for current and future retiree health benefits, but rather the spending down of federal tax expenditure subsidies granted in years past and originally intended to favor the provision of pension retirement benefits to employees. Budgetary prudence calls for us to be as vigilant in dipping into savings accumulated out of prior revenues as in deciding to spend current and future revenues. If, however, viewed on an overall basis there is a present value revenue savings to these proposals, we believe it is appropriate to consider such proposals as interim measures without the full study that is appropriate before a new general tax incentive for funding retiree health benefits is adopted, assuming the considerations discussed below are adequately addressed.

We believe that the three excess asset transfer proposals discussed above should be analyzed in terms of several general considerations. First, Congress should carefully weigh the limitations that are appropriate to impose on transfers from an existing qualified retirement plan arrangement that relieve an employer from obligations for retiree health benefits and that may be used for the provision of retiree health benefits to employees other than current and former participants in the

transferor plan. In general, the rationale of the exclusive benefit doctrine would indicate that assets from a qualified retirement plan may not be used for other than the benefit of covered employees unless the plan is terminated, benefits are fully vested and the liability for accrued benefits of the participants fully annuitized. Thus, the appropriate type and level of employee protection that should be required with respect to the benefits under the plan from which the proposed transfers are made should be carefully thought through. On the one hand, we believe the CRIS proposal does not provide an appropriate level of protection for participants under the retirement plan. On the other hand, the protection imposed in the House Ways and Means proposal perhaps could be better focused. The drain on pension assets imposed by annuitization, for example, could well be foregone under circumstances in which adequate assets remain for employees in the pension plan. We believe the level of excess assets required under the retirement plan pursuant to the House Ways and Means Committee proposal would be sufficient without annuitization.

The second important consideration in analyzing these proposals is the retiree health benefits provided with the funds transferred. In this regard, as discussed above, we believe it is inappropriate to provide another significant tax incentive for early retirement benefits. Moreover, at this point we prefer to limit the liabilities that may be funded with the transferred assets under the House Ways and Means Committee proposal, because of our lack of actual experience with the operation of such a proposal in practice.

Third, the precise treatment of the transferred assets under all three proposals is insufficiently developed at this point. The Subcommittees should consider whether it is appropriate for the class of beneficiaries of such health benefits to be different from the class covered by the qualified retirement plan from which the transfers are made, and the nature of the non- discrimination rules which should apply with respect to the health benefits. We would be pleased to work with the staff of the Subcommittees on the technical aspects of this treatment as expeditiously as possible.

If an acceptable interim excess asset transfer proposal can be structured that generally meets the policy criteria outlined above and that produces a net present value revenue gain over the long term, the Treasury Department would not oppose such a proposal. In this regard, we believe the House Ways and Means Committee proposal represents the best framework for developing a conservative statutory approach to this issue which balances all the competing considerations. However, proper consideration of pension policy issues, such as adequacy of funding for the Pension Benefit Guaranty Corporation and its potential measured liability, and retiree health policy issues would be required before the Administration could agree to proposals similar to those discussed above. The Treasury Department stands ready to work with the Members of these Subcommittees and with Congress to address our mutual concerns immediately.

PART II. EMPLOYEE STOCK OWNERSHIP PLANS

I would now like to turn my attention to the issues the Subcommittees have asked the Treasury Department to address regarding the tax treatment of employee stock ownership plans (ESOPs). My remarks are here briefly set forth: (1) the relevant tax benefits enjoyed by ESOPs under present law; (2) the three proposals currently pending before Congress in which the Subcommittees have expressed particular interest (i.e., Senator Bentsen's bill, S. 1303, Senator Dole's bill, S. 1171, and the ESOP provisions of the revenue reconciliation bill presently being developed in the House Ways and Means Committee); and (3) the views of the Treasury Department regarding these proposals.

Present Law

Since the enactment of ERISA, ESOPs have been afforded special treatment relative to other qualified retirement plans. ESOPs, together with other "eligible individual account" plans, are not subject to ERISA's prohibition on acquiring and retaining an investment in qualifying employer securities that exceeds 10 percent of the fair market value of their assets, and they are generally exempt from the prudence and diversification requirements of ERISA. An ESOP may also purchase the stock from (or sell the stock to) the employer, a major stockholder, or another party in interest without violating the prohibited transaction rules if the stock is purchased or sold for adequate consideration and if no commission is charged. Finally, despite the general prohibition on the extension of credit between a plan and a party in interest, an ESOP may finance its stock purchase by a loan guaranteed by the employer if the interest rate is reasonable, the loan is primarily for the benefit of plan participants and their beneficiaries, and certain other conditions are met. As

a result of these rules, taken together, ESOPs have proven to be a major tool of corporate finance.

In addition, in recent years, a number of additional tax benefits have been provided with respect to ESOPs. The two provisions of present law that have attracted the greatest attention in the current legislative debate are sections 133 and 404(k) of the Internal Revenue Code. Under section 133, commercial banks, insurance companies, corporations in the business lending money and regulated investment companies (collectively "qualified lenders") may exclude from gross income 50 percent of the interest received with respect to a "securities acquisition loan" used to acquire employee securities for an ESOP. A securities acquisition loan is generally defined as: (1) a loan to a corporation or to an ESOP to the extent the proceeds are used to acquire employer securities for the ESOP; or (2) a loan to a corporation to the extent the corporation transfers an equivalent amount of employer securities to the ESOP that are allocable to accounts of ESOP participants within one year of the date of the loan (a so-called "immediate allocation loan").

In Revenue Ruling 89-76, the Internal Revenue Service held that the section 133 interest exclusion applies to qualified lenders regardless of whether the original purchaser of the debt, or other purchasers in the chain of title, are qualified lenders. Thus, as long as the purchaser claiming the section 133 exclusion is itself a qualified lender, it is immaterial that other purchasers before or after it in the chain of title are not qualified lenders. The effect of the ruling is to expand the capital markets for ESOP debt and to permit investment banks (which are barred from acting as commercial banks under the Glass-Steagall Act) to underwrite ESOP debt issues on a firm commitment basis.

Section 404(k) of the Internal Revenue Code grants corporations a current deduction on dividends paid with respect to employer securities held by an ESOP to the extent the dividend is passed through to participants or is used to make payments on an exempt loan to the ESOP. If the dividend is paid with respect to stock already allocated to a participant's account and is used by the plan to make payments on an exempt loan, the plan must replace those earnings by providing that employer securities with a fair market value at least equal to the amount of the dividend are allocated to the participant's account for the year (the "make-whole" provision). In a recent private letter ruling, the Internal Revenue Service held that the deduction under section 404(k) applies to dividends paid with respect to employer securities allocated to participants' accounts and used to make payments on an exempt loan, even though the employer securities involved were not acquired with the exempt loan. The practical effect of this ruling has been to expand significantly the size of an ESOP debt issue where an ESOP already holds large amounts of employer securities.

The Internal Revenue Code also provides several other tax benefits that are unique to ESOPs. A special limit on deductions for amounts used to pay principal on an ESOP loan is provided under section 404(a)(9). Section 2057 grants an estate tax deduction, subject to certain limitations, equal to 50 percent of the proceeds for sales of employer securities by an estate to an ESOP. Section 2210 permits an ESOP to assume the estate tax liability of an estate under certain circumstances to the extent the ESOP has received employer securities from the estate or its decedent. Annual additions to participant accounts in an ESOP generally enjoy a special higher limit under section 415(c)(6)(A). Under section 382(l)(3)(C), acquisitions of employer securities by an ESOP are ignored for purposes of determining a change in ownership that otherwise might lead to a reduction in net operating losses from the pre-change period under section 382(a).

Description of Proposals

The Subcommittees have asked for the views of the Department of the Treasury on three of the proposals currently under consideration in the Congress regarding the tax treatment of ESOPs. The three proposals are: (1) Senator Dole's bill, S. 1171; (2) Senator Bentsen's bill, S. 1303; and (3) the ESOP provisions included in the revenue reconciliation bill pending in the House Ways and Means Committee. A brief description of each of these proposals follows.

The Dole Bill. Senator Dole's bill (S. 1171) would repeal section 133 in its entirety effective for loans made after June 6, 1989, subject to certain transition rules.

The Bentsen Bill. Senator Bentsen's bill (S. 1303) would amend section 133 to disallow the 50 percent interest exclusion for qualified holders of ESOP debt unless: (1) immediately after the acquisition of employer securities with the exempt loan the ESOP owns at least 30 percent of each class of outstanding stock of the corporation issuing the employer securities or 30 percent of the total value of all outstanding stock of the issuing corporation; (2) the term of the loan does not exceed 15 years;

and (3) each participant is entitled to direct the plan as to the manner in which shares acquired with the loan and allocated to the participant's account are to be voted. The bill also imposes an excise tax, subject to certain exceptions, if the ESOP disposes of employer securities either within three years of their acquisition or without having allocated either the securities or the sale proceeds to participants' accounts. The bill is generally effective for loans made after June 6, 1989, subject to certain transition rules.

The Ways and Means Proposal. Under the Ways and Means proposal, the benefits under sections 133 and 404(k) would be eliminated, effective as of July 10, 1989, except in the case of ESOPs which own at least 30 percent of the outstanding stock of the corporation, and the section 404(k) deduction would only be available if the dividend is paid out to participants or, with respect to stock purchased with an exempt loan, if the dividend is used to pay the exempt loan. At the same time, the special estate tax provisions, the ESOP modification to the section 415 limit, and the special section 382 rule for ESOPs would be eliminated. Moreover, Revenue Ruling 89-76 would be legislatively overruled.

Administration Position

The Administration strongly supports the broad objectives of ESOPs and recognizes that the purpose of enacting the section 133 partial interest exclusion to encourage the use of ESOPs was a laudatory one. Unfortunately, however, the revenue cost of the interest exclusion has proven to be too large in this period of budgetary constraint to justify the full continuation of this tax benefit. For that reason, the Administration would support either the repeal of section 133 or the imposition of substantial constraints on section 133 consistent with the purposes of ESOPs, as in the case of Chairman Bentsen's proposal or the House Ways and Means Committee proposal.

Because of its concern that the simultaneous elimination or modification of sections 133 and 404(k) would have a material effect on the rate of adoption of ESOPs, the Administration opposes the repeal of section 404(k) at this time. Nonetheless, we recognize concern that this benefit has been insufficiently targeted to promote the increase of meaningful ESOP participation. For that reason, we do not oppose the House Ways and Means Committee proposal restricting the circumstances under which the section 404(k) deduction is permitted to better target the tax benefit in accordance with its purpose.

This concludes my written remarks. I would be happy to answer any questions the members of the Subcommittees might have at this time.

COMMUNICATIONS

STATEMENT OF THE AFL–CIO

The AFL–CIO is deeply concerned about recent proposals to fund retiree health benefits with so-called "excess assets" of defined benefit pension plans. In our view, pension fund assets are held in trust for the exclusive benefit of participants and beneficiaries. We therefore oppose using pension funds to finance retiree health benefits. However, if Congress does allow such transfer of assets, basic protections for both pension and retiree health benefits should be included in the legislation.

Until recently, many workers felt confident that their post-retirement health care needs would be met by benefits provided by their employer. High health care costs, the recent Financial Standards Accounting Board's (FASB) rule on post-retirement benefits, and the aging of the workforce have increasingly forced workers to face employer proposals to cutback or even eliminate their retiree health benefits.

The AFL–CIO believes that a national health care program would stop the erosion of both retiree and active worker health benefits. Until that national program Is enacted, retiree health benefits are in jeopardy without basic protections such as vesting, accrual, and minimum benefit standards. Recent proposals to use excess pension assets to fund retiree health benefits do not remedy these gaps in benefit protection.

Without basic benefit protections, proposals to transfer excess pension assets to fund retiree health are nothing more than windfalls for employers. Most employers with defined benefit plans will have a significant financial incentive to transfer excess assets to fund retiree health benefits because, according to the Department of Labor, 50% of defined benefit plans are funded over 150% of current liability. For purposes of FASB, this movement of assets will decrease employers' paper liabilities and boost their credit rating. More importantly, the transfer approach eases employers' cash flow for funding health benefits, because employers do not have to generate new tax-exempt dollars for payment of retiree health benefits. This windfall to employers is shared by Congress in the form of a short-term revenue gain. But Congress and employers have yet to address the potential long-term revenue loss as projected by the Department of the Treasury.

For workers and retirees, these proposals are flimsy verbal promises from employers that they will maintain some form of retiree health benefits, with a cut-back in pension fund assets that remain to meet future obligations and guard against unexpected market downturns. Major studies on employer objectives for retiree health indicate employer intentions to cutback the level of, and payment for, retiree health benefits. Employer interest in capping liability for future retiree health benefits has resulted in the conversion of retiree health benefits from defined benefit to defined contribution dollars, further shifting the risk and increased costs of this benefit to workers. The result is that workers' pension fund assets could be used to fund a benefit to which they currently have no vested legal rights. Also of concern is that pension fund assets may be used to fund retiree health benefits for other workers not covered by the pension plans.

Absent strong protections for their pension benefits, workers and retirees are left with weakened benefit security and continued employer raiding of terminated pension assets. For over a decade, employers have skimmed off $20 billion in so-called excess pension assets from pension plans without $1 of those excess assets allocated to plan participants. Employers taking reversions have made unilateral decisions regarding these monies that have not, for the most part, been in the best interests of plan participants. A recent General Accounting Office study on reversions found that 40 percent of surveyed companies taken over in leveraged buyouts terminated their pension plans after the takeover.

The policy contradiction is exacerbated when some proposals provide for a cushion to protect active workers' pensions in the event of a transfer, but fail to offer the same provision for active workers in a terminated plan. The simplicity of the benefit security issues involved in a withdrawal from an on-going plan, or a termination with a reversion, should not be ignored. Clearly, some members of Congress are more interested in revenue bottom lines than the welfare of workers or retirees.

In summary, the AFL–CIO opposes the transfer of so-called excess assets from pension plans as a source of funding for retiree health benefits. If Congress allows employers to transfer assets from "overfunded" plans to retiree health accounts, certain health and pension protections for plan participants should be included in the legislation. Assets transferred from an overfunded pension for the purpose of meeting retiree health care obligations should be used only to finance benefits for the participants in the pension plan. Employers choosing to transfer pension assets to fund retiree health should maintain current levels of benefits and out-of-pocket expenses for current retirees. A maintenance of effort provision for five years for future retirees health insurance should be followed by requirements for minimum retiree health benefits. Retiree health benefits should be subject to minimum vesting and accrual rules.

We believe that, short of a total ban on terminations and reversions, active workers and retirees who experience a termination and reversion should be entitled to a fair share of so-called "excess assets." These "excess assets" should not be available to employers until an adequate cushion exists for any on-going plans that would shield worker and retiree pension benefits from unexpected market downturns and inflation. Financial incentives, in terms of the amount of excess assets available to employers, should exist to encourage the continuation of defined benefit plans. Minimum benefits should be required for employers who replace pension plans with less generous ones, and workers should have access to some kind of deferred compensation savings plan in the event that no replacement plan exists.

Turning to the issue of ESOPS, we wish to go on record in support of the elimination of the abuses in ESOP financing. ESOPs only achieve their purpose in situations where workers are, in fact, given an opportunity to attain a beneficial equity interest in their company and an effective voice in management. Special ESOP tax benefits are not in order in situations where the ESOP financing is used as another opportunity for tax avoidance.

We, therefore, (1) support revocation of the recent IRS revenue ruling (89–76) which substantially broadened the definition of "Qualified Lenders" who are entitled to the 50% interest exclusion, and (2) we believe certain requirements which assure appropriate employee ownership and representation should be met in order to qualify for the interest exclusion and the dividends paid deduction.

Specifically, we believe the interest exclusion on loans to ESOPS and the deduction for the dividends paid to an ESOP should be allowed only in situations where: (a) At least 30 percent of the equity in the corporation is owned by the ESOP and, (b) Workers or their representatives are adequately represented on the ESOP Trust and, (c) Voting rights are proportionate to ownership and "passed through" to the employee at a rate no slower than the rate by which the loans used to acquire the securities are repaid, with unallocated shares voted in the same proportion as allocated shares and, (d) There is full disclosure of information on a continuing basis concerning the structure and finances of the ESOP and the employer, with particular emphasis on risks and prospects for the future.

We were pleased to note that the Ways and Means Committee action of July 14 endorsed the 30 percent ownership criterion. That action standing alone is not, however, sufficient to solve the problem.

The issue of voting rights must also be addressed. The proposal of Senator Bentsen to limit Sec. 133 benefits to ESOPS whose stock passes all voting rights through to the employees is an important step in this direction. We believe that the requirement of pass-through voting should be extended to all ESOPs. There is no pass-through requirement, for example, on voting for the board of directors in companies which do not have a registration-type class of securities. Senator Bentsen's bill would create this requirement only if loans to the ESOP were to qualify for the interest exclusion. In our view, tax benefits should never be allowed for ESOPs in which employees are not given a right to participate in the governance of the company. And tax benefits should not be granted to companies in which management is trying to entrench itself by creating an ESOP, but denying voting rights to the owners of the stock.

The Bentsen bill should be improved by requiring that: unallocated shares should be voted in the same proportion as allocated shares; there should be adequate worker representation on ESOP trust, and there should be full information on a

continuing basis about ESOP finances. We would be remiss if we did not note that the goal of worker participation could be thwarted in a company that provides minority stock to the ESOP. In such circumstances, additional conditions should be devised for both the interest exclusion and the dividends paid deduction.

The Bentsen bill provides the first real hope of ESOP reform and, with these additions, that bill will assure true worker participation as originally intended.

The AFL–CIO appreciates the opportunity to present its views on these issues.

ALLIED-SIGNAL, INC.,

Washington, DC, August 9, 1989.

Hon. LLOYD BENTSEN, *Chairman,*
Senate Finance Committee,
Dirksen Senate Office Building,
Washington, DC.

Dear Mr. Chairman: Legislation has been proposed in S. 1303 and S. 1171 that would repeal the partial interest exclusion for loans made to purchase stock for an ESOP. The purpose of the attached statement is to focus on the impact of that proposed legislation on an alternative form of an ESOP loan transaction, the so-called "immediate allocation loan" under Section 133(b)(1)(B) of the Code.

Allied-Signal believes immediate allocation loans should be retained. If, however, the Senate Finance Committee decides to repeal the partial interest exclusion for all ESOP loans, Allied-Signal urges you to provide, as a matter of equity, grandfathering of immediate allocation loan transactions for the employers that were engaged in such transactions on June 6, 1989. S. 1303 and S. 1171 are directed at leveraged ESOP loan transactions that typically involve a large one-time borrowing and purchase of employer stock. The grandfather provisions are directed at a leveraged ESOP loan transaction that had substantially progressed on June 6, 1989. In contrast, immediate allocation loans typically involve periodic small borrowings to fund current contributions and therefore do not have the characteristics necessary to meet the grandfather exceptions as drafted.

Allied-Signal believes that as a matter of fundamental fairness, immediate allocation loans should receive grandfather relief substantially equivalent to that afforded the leveraged ESOP loan transactions. Thus, any employer that had been engaging in immediate allocation loans on June 6, 1989, should be permitted to continue those loans for a period of time that would be substantially equivalent to the period of time that would have been covered by a leveraged ESOP loan transaction done on June 6, 1989.

We have attached a more detailed explanation. We would welcome the opportunity to discuss this further with you.

Sincerely,

KEN W. COLE, *Vice President,*
Government Relations.

Attachment.

STATEMENT OF ALLIED-SIGNAL, INC.

SUMMARY

Legislation has been proposed in the form of S. 1303 and S. 1171 which would repeal the partial interest exclusion presently available to fund stock purchases for ESOPs. The purpose of this statement is to focus on the impact of the proposed legislation on an alternative form of ESOP loan transaction, the so-called "immediate allocation loan." Allied-Signal believes that the partial interest exclusion should be continued for immediate allocation loans as a reasonable and moderate means of continuing tax incentives for employee stock ownership. If, however, the Senate Finance Committee decides to change the current ESOP tax laws, Allied-Signal urges you as a matter of fundamental fairness to take account of the differences in structure of immediate allocation loans by providing special grandfathering rules for such loans for ESOP programs that were utilizing such loans on June 6, 1989.

PRESENT LAW

A bank, an insurance company, a corporation actively engaged in the business of lending money, or a regulated investment company may exclude from gross income 50 percent of the interest received with respect to a "securities acquisition loan"

used to acquire employer securities for an ESOP (Sec. 133 of the Code). A "securities acquisition loan" is generally defined as (1) a loan to a corporation or to an ESOP to the extent that the proceeds are used to acquire employer securities for the ESOP, or (2) a loan to a corporation if within 30 days after the loan an equivalent amount of employer securities is transferred to the ESOP and such securities are allocable to accounts of ESOP participants within one year of the date of the loan (an "immediate allocation loan").

S. 1303 AND S. 1171

S. 1171 would repeal the partial interest exclusion currently available under Code Section 133 for ESOP loans. S. 1303 also would repeal the partial interest exclusion, except for certain limited circumstances in which it would remain available. Both bills generally would be effective with respect to loans made after June 6, 1989. Both bills contain grandfather rules for certain loans made after June 6, 1989, which focus on either the existence of a loan commitment on that date or the existence of an arrangement to purchase the shares with the proceeds of the loan.

ALLIED-SIGNAL INC.

Allied-Signal is an advanced technology company with businesses in aerospace, automotive products and engineered materials. The company is 29th on the Fortune 500 list of the nation's largest industrial firms.

Allied-Signal presently has three savings plans that qualify, wholly or partially, as ESOPs covering over 40,000 participants, or approximately 80 percent of the eligible employees. Together these plans hold over 22 million Allied-Signal common shares representing approximately 15% of the outstanding stock. Under Allied-Signal's immediate allocation loan program, which has been in effect since July 1987, Allied-Signal borrows each month on an interest-reduced basis an amount necessary to fund its employer matching contributions to the plans for that month. The loan proceeds are used to purchase shares on the open market which are contributed to the plans and immediately allocated to individual employees' accounts.

IMMEDIATE ALLOCATION LOANS SHOULD BE RETAINED

The partial interest exclusion for immediate allocation loans should not be repealed by the proposed legislation because they are substantively different from the leveraged ESOP transactions at which S. 1303 and S. 1171 are directed. Because of these differences, immediate allocation loans do not create an abusive loophole; rather they utilize in a moderate and reasonable manner the tax incentives for ESOPs to achieve the purposes for which those incentives were enacted.

The leveraged ESOP transactions typically involve the purchase of a large number of shares of employer stock that are held unallocated in the ESOP for a period of years while the debt is paid off. Appreciation in the value of the stock typically goes to the benefit of the employer until the shares are allocated. In contrast, since immediate allocation loans require that the employer stock be allocated to participant accounts within one year, such loans result in an immediate interest in the employer stock on the part of the participants and future appreciation goes to the benefit of the employees.

Moreover, since the one-year allocation requirement limits the size of the permissible stock purchase, the current revenue loss is significantly reduced as compared to the leveraged ESOP transactions that contemplate a large up-front borrowing. Further, since the interest exclusion period for an immediate allocation loan is limited to seven years, while for a leveraged ESOP transaction there is no limit (and they typically would run much longer), the overall revenue loss would be smaller in the case of an immediate allocation loan.

Finally, since the immediate allocation loan program contemplates a much smaller borrowing and does not involve any significant corporate financing transactions, such as a major share repurchase or a recapitalization into convertible preferred stock, investment bankers do not reap excessive profits from these transactions.

Thus, in contrast to the leveraged ESOP transactions, immediate allocation loans provide moderate and reasonable assistance for the establishment of ESOPs.

Allied-Signal's experience in this regard is instructive. The Signal Savings and Stock Purchase Plan was not an ESOP prior to July 1, 1987. Employer matching contributions to that plan could be invested in any of the plan's available investment alternatives at the direction of the participant. In order to convert the plan to an ESOP to qualify for immediate allocation loans eligible for the partial interest exclusion, the terms of the plan were changed to require that all employer matching contributions be invested only in employer stock.

On the benefit increase side, Allied-Signal's first borrowing under the 50% interest income exclusion provision was in April, 1987. At the same time the Allied-Signal Board of Directors approved an increase in the employer matching contribution (which is invested in Allied-Signal stock) from a 50% match to 100% match for employees with more than five years of participation in the plan. The availability of reduced interest financing for the employer matching contributions, because of the partial exclusion of interest income for the lenders, was a factor taken into account.

Immediate allocation loans should be retained as an incentive to create employee stock ownership without resulting in tax abusive transactions.

IMMEDIATE ALLOCATION LOANS SHOULD GET FAIR GRANDFATHER RULES

The grandfather provisions in S. 1303 and S. 1171 that allow loans made after June 6, 1989 to be eligible for the partial interest exclusion should, as a matter of fundamental fairness, be modified to allow immediate allocation loans be eligible for the partial interest exclusion. Such a provision would recognize the fundamental differences in form between immediate allocation loans and leveraged ESOP loan transactions in order to put all employers in substantially the same economic position.

The need for a modification of the grandfather provisions is made apparent by contrasting the structure of the immediate allocation loan transactions described above with the typical leveraged ESOP transactions that formed the basis for the grandfathering rules. In the latter, the employer typically borrows a large amount of money in a single transaction that is to be repaid from plan contributions and dividends on stock over a period of years, typically 10 to 15 years. The loan proceeds are reloaned to the ESOP which then purchases employer stock with those proceeds. The shares are held in suspense as security for the loan and are allocated to accounts of participants over the term of the loan as the loan is paid off.

The leveraged ESOP loan transaction is the transaction at which the proposed repeal of the partial interest exclusion is directed. As such, the form of those transactions shaped the basis for the grandfather provisions. Since those transactions involve one borrowing, the grandfather provisions include an exception for loans pursuant to a loan commitment that was in effect on June 6, 1989. Similarly, since those transactions involved a large stock purchase, the grandfather provisions include an exception for transactions having a stock purchase arrangement in effect on June 6, 1989.

Immediate allocation loans typically do not have either type of commitment in effect for an amount comparable to that involved in the leveraged ESOP transaction. Because immediate allocation loans are made periodically and in small amounts, lenders will not commit to a long-term loan arrangement. Similarly, since the purchases of stock are small and are over an extended period, there is no necessity to enter into any sort of a stock purchase arrangement. Thus whereas the leveraged ESOP borrower can borrow a large amount, typically hundreds of millions of dollars, that will cover its plan contributions for a number of years in the future while retaining the partial interest exclusion, the immediate allocation loan borrower may completely lose any ability to borrow amounts related to future contributions simply because its form of transaction had no need for loan commitments or purchase arrangements.

As a matter of fundamental fairness, the immediate allocation loan borrower should be placed on an equal economic footing with the leveraged ESOP borrower. Thus, the immediate allocation loan borrower also should be permitted to borrow its future contribution requirements with the partial interest exclusion. This can be accomplished by permitting any employer that was using immediate allocation loans on June 6, 1989 with respect to an ESOP to continue using immediate allocation loans eligible for the partial interest exclusion with respect to that ESOP. The period of time allowed for such immediate allocation loans should be substantially equivalent to the period of time that would have been covered by a typical leveraged ESOP loan transaction.

CONCLUSION

Since immediate allocation loans are not vehicles for use of tax benefits as an abusive loophole and have the positive effects originally sought when the tax benefits for ESOPs were enacted, any change in ESOP tax laws should be modified to leave available the partial exclusion of interest income for immediate allocation loans. If however the Senate Finance Committee terminates the interest exclusion provision for ESOP loans after June 6, 1989, the grandfather provisions of the legislation should be modified to take into account the different methodology used for immediate allocation loans.

Harvey R. Holding
Executive Vice President-
Chief Financial Officer

BellSouth Corporation
Suite 2003
1155 Peachtree Street, N.E.
Atlanta, Georgia 30367-6000
404 249-2090

August 9, 1989

Ms. Laura A. Wilcox
Hearing Administrator
Senate Finance Committee
SD-215
Washington, D.C. 20510

Re: BellSouth's Statement for the ESOP Hearing Record - July 19, 1989 (S.1303 and S.1171)

Dear Ms. Wilcox:

On behalf of BellSouth Corporation, this statement is submitted for the printed record of the joint hearing held on July 19, 1989 by the Subcommittees on Taxation and Debt Management and on Private Retirement Plans and Oversight of the Internal Revenue Service.

BellSouth, through its subsidiaries, provides local exchange telecommunications services in nine Southeastern states and a variety of other services related to telecommunications across the United States and in a number of foreign countries. BellSouth currently sponsors a defined benefit pension plan and a section 401(k) profit sharing plan for the benefit of its employees. As discussed herein, the company has taken substantial steps toward the adoption and implementation of a leveraged ESOP for the benefit of employees. The recent bills introduced in the Senate (S.1303 and S.1171) along with proposed legislation tentatively agreed to by the House Ways and Means Committee (H.R.3150) would cause BellSouth to cancel its leveraged ESOP implementation plans for financial reasons.

For the reasons discussed in this letter, BellSouth opposes the repeal of Code section 133 as contemplated by S.1303 and S.1771. BellSouth also would like to go on record as being opposed to the repeal of Code section 404(k) dividends paid deduction as contemplated by H.R.3150. BellSouth believes that the repeal of Code sections 404(k) and 133 in any event should not apply with respect to ESOP debt to be guaranteed by BellSouth and incurred by the BellSouth ESOP for which a registration statement was filed with the Securities and Exchange Commission on June 30, 1989, and with respect to the common stock of BellSouth to be acquired pursuant to such debt.

1. BellSouth Opposes The Repeal Of Code Sections 404(k) And 133.

BellSouth opposes the repeal of the dividends paid deduction in Code section 404(k) and the partial interest exclusion in Code section 133. The repeal of the dividends paid deduction in Code section 404(k), as proposed by the House Ways and Means Committee, would directly reduce benefits provided to ESOP participants. The dividends paid deduction is a strong incentive for an ESOP's sponsor to pay dividends directly to participants or to use the dividends to make payments on an ESOP loan, which

results in additional shares being allocated to participants' accounts. For example, in the collective bargaining agreement just negotiated by BellSouth covering over 60,000 employees, a 10% additional corporate matching contribution is conditioned on the company's ability to deduct dividends under Code section 404(k). Without the Code section 404(k) dividends paid deduction, BellSouth for financial reasons would not implement a leveraged ESOP, and provide the 10% additional corporate matching contribution, for these employees.

The company understands that repeal of the partial interest exclusion is targeted at lenders and the financial community as being the primary beneficiaries of such exclusion. The rationale of the partial interest exclusion is that if lenders pass lower interest rates on to the ESOP, participants benefit because the ESOP may borrow a larger principal amount and purchase more stock to be allocated to participants' accounts. However, it has been perceived that lenders generally retain the benefit of the interest exclusion for themselves without providing a material decrease in the interest rate charged on ESOP loans. BellSouth's evaluation is that the partial interest exclusion does result in lower interest rates being charged on ESOP debt and greater benefits being provided to ESOP participants, and BellSouth therefore also opposes the repeal of the partial interest exclusion.

2. Any Repeal Of Code Sections 404(k) and 133 Should Not Apply To The BellSouth ESOP.

BellSouth has expended significant corporate resources in planning and implementing an ESOP for its employees in reliance on the Code provisions in effect prior to the proposed legislation. All of these expenditures preceded any public discussion of the repeal of Code section 404(k), and most of these expenditures preceded any public discussion of the repeal of Code section 133.

An interdepartmental task force established in 1988 made an exhaustive study of ESOPs, and a Board of Directors committee on April 24, 1989 was informed of, and encouraged, the company's consideration of the adoption of an ESOP. At a meeting of BellSouth's senior officers on June 2, 1989, it was determined that the company should adopt an ESOP to increase its employees' stake in the company and should attempt to obtain the lowest possible interest rate on the ESOP debt through an ESOP public debt issuance guaranteed by the company. As discussed previously, employees would benefit from the ESOP's ability to borrow at lower interest rates because the ESOP then could borrow a larger amount and purchase more BellSouth stock to be allocated to the employees' accounts under the ESOP. The Board of Directors on June 26, 1989 approved the establishment of the ESOP, the issuance of ESOP debt and purchase of BellSouth shares, and the company issued a public and an employee announcement on that same day.

BellSouth immediately attempted to implement the ESOP. A debt registration statement was filed with the Securities and Exchange Commission on June 30, 1989, by which time the company had adopted the ESOP plan and trust. The company and the ESOP trustee currently are waiting for the SEC to review and declare the registration statement effective.

BellSouth already has incurred substantial implementation cost and fees, which may exceed $1 million, for such items as trustee fees and expenses to insure the fairness of the financing

and stock purchase to participants, plan and trust documentation and recordkeeping changes, registration and printing fees, legal and accounting fees and related expenses.

BellSouth incurred expenses in establishing the ESOP and raised employee and public expectations on the assumption that ESOP tax incentives, particularly the Code section 404(k) dividends paid deduction, would continue in present form. This assumption was reasonable given the national policy favoring employee stock ownership as expressed through increasingly favorable ESOP tax legislation over the past decade.

BellSouth appreciates the fiscal concerns that, at least in part, may have fueled the repeal effort. However, it would be inequitable for the repeal to apply to the company's ESOP after the company had expended significant corporate resources and taken significant steps toward the adoption and implementation of its ESOP. In addition, repeal would directly harm the company's employees, who had expected to receive the benefits provided by the ESOP.

BellSouth understands that S.1303 and S.1171 would except from the repeal of Code section 133 ESOPs that had taken certain actions on or before June 6, 1989. BellSouth supports the framework of the effective date provisions of S.1171. However, the company believes that the effective date should be keyed to July 10, 1989, as contemplated by the effective date provisions of the Ways and Means Committee proposed legislation.

In the alternative, BellSouth supports the following changes to the effective date provisions of the Ways and Means Committee proposed legislation. That legislation extends current treatment under Code sections 404(k) and 133 to ESOP loans, and stock purchased with loan proceeds, which were made on or before July 10, 1989. BellSouth understands that this grandfather treatment also applies to ESOP loans made pursuant to a binding written commitment in effect on July 10, 1989, provided that a binding written commitment to purchase the stock or a tender offer registered with the SEC also was in effect on July 10, 1989.

BellSouth believes that this grandfather rule also should apply to loans, and stock acquired with loan proceeds, with respect to which a registration statement was filed with the SEC on or before July 10, 1989. As noted previously, BellSouth filed a debt registration statement with the SEC on June 30, 1989. By filing the registration statement, BellSouth evidenced its commitment to establish the ESOP, and this commitment should qualify the ESOP for grandfather treatment.

The BellSouth ESOP was, and remains, unable to borrow money under its registration statement because the SEC has not completed its review of the registration statement and the registration statement thus has not been declared effective. Thus, despite BellSouth's commitment to establish the ESOP, the ESOP effectively was precluded from taking the action that was needed to secure grandfather treatment under the existing grandfather proposal.

BellSouth believes that if such grandfather treatment is not extended to its ESOP, it will have been penalized for failing to abandon its implementation plans, developed over the past year and before any public discussion of ESOP legislation, in favor of precipitous action based on rumor to obtain possible grandfather

treatment. The company believes that such action would have resulted in terms which were not nearly as favorable to its employees as those subsequently arranged.

In summary, BellSouth opposes the proposed repeal of Code sections 404(k) and 133. These Code sections provide tax incentives for the establishment of ESOPs that, in turn, provide meaningful benefits to participants. In addition, if these sections are repealed, BellSouth respectfully submits that grandfather rules should be adopted as discussed above which allow it to implement its ESOP, financing and stock purchase plans under current tax treatment.

Sincerely,

Harvey R. Holding

Ms. Laura A. Wilcox
Hearing Administrator
Senate Finance Committee
SD-215
Washington, D.C. 20510

Re: BellSouth's Statement for the Retiree Health Hearing Record for July 19, 1989

Dear Ms. Wilcox:

On behalf of BellSouth Corporation, this statement is submitted for the printed record of the joint hearing held on July 19, 1989 by the Subcommittees on Taxation and Debt Management and on Private Retirement Plans and Oversight of the Internal Revenue Service. This statement focuses on the issue of allowing transfers of certain assets from employee pension plans to fund retiree health obligations.

BellSouth, through its subsidiaries, provides local exchange telecommunications services in nine Southeastern states and a variety of other services related to telecommunications across the United States and in a number of foreign countries. BellSouth currently provides comprehensive post-retirement medical benefits for some 32,000 former employees and their dependents. Of these former employees, approximately 60% are former non-management employees with respect to whom such benefits were the subject of the collective bargaining process and less than 8% are "highly compensated employees" as that term is defined in the Internal Revenue Code section 414(q).

We are constantly seeking means of efficiently setting aside funds in anticipation of the considerable and rapidly growing liability with respect to our retirees. The need for employers such as BellSouth to anticipate these obligations and make some provision therefor is becoming even more critical in these days of spiraling costs of providing health care benefits to retirees. We feel that a significant step in the direction of enhanced security for these benefits can be accomplished through the rededication of certain "surplus" assets of well-funded pension plans to this purpose.

BellSouth is a member of the Coalition for Retirement Income Security (CRIS) and endorses the proposal for permitting the transfer of pension plan assets to a retiree medical trust submitted by CRIS at the July 19, 1989 Joint Subcommittee hearing. Briefly, the CRIS proposal would allow a voluntary, tax-free transfer of surplus pension assets to a trust to pay medical benefits of retirees. A maximum of three transfers would be permitted in a ten year period. The amount transferrable would be limited to a defined, actuarially determined surplus amount in the pension plan. It would also be limited by the amount of the retiree health liability at the time of transfer. Earnings on amounts transferred would not be subject to income taxes.

The CRIS proposal offers employers who have responsibly funded their pension plans the opportunity to enhance retiree medical benefit security from that pool of funds while requiring cushions which would eliminate any negative impact on pension security. Additionally, all of this is accomplished with a projected increase in current tax revenues.

We feel that one aspect of the CRIS proposal is particularly notable. Under the CRIS proposal, an asset transfer would not constitute a reversion and would not require vesting or annuitization of pensions. To condition such a transfer on its designation as a reversion or to impose such additional requirements normally associated with plan terminations would appear to further no legitimate objective and would merely serve to impose unnecessary roadblocks for employers seeking to enhance retiree medical benefit security through this mechanism. BellSouth similarly believes that it would be inappropriate to condition an asset transfer on the existence of a plan provision which allows for a reversion of assets upon plan termination. To do so would make such transfer mechanism unavailable to those employers who have tried to ensure that pension plan assets are used for employee, rather than corporate, purposes.

BellSouth commends you for your consideration of this critically important issue and we appreciate the opportunity to comment.

Sincerely,

Harvey R. Holding

Harvey R. Holding

STATEMENT OF BOISE CASCADE

BOISE CASCADE'S EMPLOYEE STOCK OWNERSHIP PROGRAM

Boise Cascade Corporation is an integrated forest products company that manufactures and distributes paper and paper products, office products, and building products and owns and manages timberland to support these operations. The company employs about 20,000 employees at over 115 manufacturing, distribution, and converting operations.

Today, Boise Cascade would like to testify to support the continuation of ESOP tax credits to qualified lenders and of dividend deductions for future ESOPs. These tax advantages have made ESOPs very effective in helping American industry to fund retirement programs and to provide employees with "portable' assets with which to fund their own retiree health care costs.

Boise Cascade adopted a leveraged ESOP in May 1989 to enhance salaried employees' retirement security and to increase their ownership/interest in the company. The ESOP is part of the company's overall retirement program. Below we have outlined Boise Cascade's retirement program and how the ESOP adds to the retirement security of about 7,000 employees:

PENSION PLAN

The Pension Plan for Salaried Employees is a defined benefit retirement plan that provides 1.25% of an employee's final average earnings multiplied by each eligible employee's years of service with the company. Full benefits can commence at age 65, or at age 62 for employees with 15 or more years of service. An employee with 30 years of service would receive 37.5% of final average earnings. The ESOP does not change the Boise Cascade defined benefit pension plan.

THRIFT SAVINGS PLAN

Boise Cascade also has a Savings and Supplemental Retirement Plan (SSRP), which is a defined contribution retirement plan. The plan allows employees to contribute from 1% to 16% of compensation on a pretax (401(k)) or after-tax basis. Employees direct their contributions into any combination of four investment funds. The company matches the first 6% of employee contributions to the plan. Before addition of the ESOP program to the SSRP, the company match was 60% of the first 6% of employee contributions, and with the addition of the ESOP program, the company match has been increased to 70% of the first 6% of employee contributions. Prior to implementation of the ESOP, company contributions could be directed by the employees into any combination of four investment funds. The ESOP provides that all future company contributions will be invested in Boise Cascade stock.

The ESOP currently holds convertible preferred stock of Boise Cascade, which is convertible at any time (by the trustee) into the company's common stock. The value of the convertible preferred stock has been designed so that its pre-share value cannot fall below its original issue price, which reduces the employee's risk of investment in company securities. The ESOP is expected to continue for the next 15 years, which is the term of the loan used to finance the ESOP. In addition to receiving "matching" allocations of company stock, during 1989 (partial plan year), the company will allocate to employees preferred stock equal to $70 times their years of service with Boise Cascade up to a maximum of $1,400. During 1990 (full plan year), the amount to be allocated to employee ESOP accounts under this "service allocation" is estimated to be $120 times years of service up to a maximum of $2,400. These ESOP funds are expected over time to provide significant assets that employees may use to obtain retiree medical insurance coverage.

RETIREE MEDICAL PLAN

The Salaried Employee Retiree Medical Plan is an unfunded self-insured program which is amended periodically by the company to reflect increasing costs and to respond to competitive plan provisions. Retirees under age 65 presently pay a "premium" of $40 per month for themselves and $40 per month for dependent care coverage. Retirees over age 65 have primary coverage through Medicare and presently pay a "premium" of $15 per month to cover themselves under the Retiree Medical Plan and $15 per month for dependent care coverage.

During the past several years, Boise Cascade has reviewed the costs and liabilities associated with its Retiree Medical Plan. The increasing liability of medical costs for retirees has become a critical problem for Boise Cascade. For this reason, Boise Cascade decided in 1988 to begin reducing its subsidy to the Salaried Employees Retiree Medical Plan and to require additional years of service for employees to receive full

benefits under the plan. The new ESOP was intended in part to provide a very valuable alternative for employees to accumulate their own assets to fund the cost of future retiree medical insurance. The ESOP is a cost-effective way for the company to provide a benefit for employees which will assist them in meeting the expense associated with obtaining retiree medical coverage in the future. Prior to the ESOP, employees had to work until age 55 and have at least ten years of service to be eligible for the Retiree Medical Plan. Under the ESOP, employees will accumulate assets that are fully vested after no more than five years of service, and there is no age requirement for vesting in the ESOP allocations.

EMPLOYEE INVESTMENT RISK

Although employees face some investment risk with the addition of the ESOP to their "retirement savings portfolio," their total retirement benefits the pension plan,-the employee-directed portion of the SSRP, and government-provided retirement benefits—are significantly diversified. In addition, assets invested in the ESOP may be diversified by employees at age 55 and again at age 60 in accordance with the requirements of the Internal Revenue Code. Even if an employee were to continue to fully invest his or her ESOP account assets in company securities, only a modest amount of his or her expected retirement benefits would be "at risk," i.e., tied to the fortunes of a single company. For example, an employee age 60 with 25 years of service who had participated in the ESOP for 15 years would have only about 15% of his or her total retirement income, including social security, in the ESOP account.

EMPLOYEE OWNERSHIP

Boise Cascade believes that employee performance and morale will be enhanced, and that the company will be more competitive in its industry overall when its employees have a significant ownership interest in the company. We believe the ESOP will provide for increased job motivation, encourage positive innovation and increase productivity.

FUTURE ESOPS

The size of the ESOP that Boise Cascade adopted this year was large enough to only effectively fund retirement benefits for the company's salaried employees. In the future, Boise Cascade would like to see continued tax incentives for ESOPs be preserved so that we could consider extending similar benefits to nonunion hourly employees and so that discussions could be held with union representatives regarding the possibility of offering ESOP benefits to all employees of the company.

CONCLUSION

Again, Boise Cascade strongly encourages the continuation of ESOP tax credits to lenders and of dividend deductions for future ESOPs. ESOPs are very effective tools to help American industry to fund retirement programs, including the tremendous liabilities that have resulted from offering retiree health care benefits. They provide a mechanism to enable workers to acquire significant ownership interests in their employers, providing incentives to improve efficiency and encourage innovation, which will ensure American industries remain competitive in the international area. The benefits provided by ESOPs are significant and in combination with other retirement vehicles, can provide a quality retirement program for employees.

BRANHAM

New York, NY, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Re: Subcommittee Hearing-July 19, 1989,
S. 1303, S. 1171
Taxation and Debt Management/Private Retirement Plans and Oversignt of the IRS

Dear Ms. Wilcox: Branham is an employee-owned sales company (the ESOP was established in 1980) with 125 associates. Since 1980 our ESOP has distributed $3.39

million to departing and retiring employees. The highest payout was to a regional manager, who was totally vested, and departed with $90,368. A secretary in 1987 without being fully vested, left with $18,138. (She would have had nearly $26,000 if she were fully vested).

We would not be in business today if it were not for the favorable terms of our ESOP loan.

We did not pass through voting rights until the mid 80's because it takes three to five years to begin to educate one's associates about the concept of how an "employee owned ESOP" should operate.

Senator Bentsen's bill contains many favorable thoughts . . . but I believe the timing is a little too ambitious. The goal should be 30% of a corporate sponsored stock held in the ESOP *within* five years and not permit the number to drop below 25% for the remainder of the loan.

It has been our experience that the American economic system has to be explained to one's associates and it takes years to get the concept of employee ownership across to people who are accustomed to being merely "workers."

Everything that you're advocating in these bills makes sense if implemented at a slower pace!

Sincerely,

C.D.J. LAFFERTY.

CANTERBURY PRESS

Rome, NY, July 19, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC

Dear Ms. Wilcox: We wish to submit this written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill.

The hearing before the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service was scheduled for today, July 19, 1989.

Speaking as the chief executive officer of our 85-employee company which is 100% ESOP owned, I wish to state that we are vitally interested in what is going on in Washington and think it is time that we stop playing political football with ESOPs.

Our ESOP was formed in 1975 as a means for our former sole owner to reward his loyal employees and, at the same time, begin divesting his interest prior to retirement.

In 1981, upon his retirement, our ESOP trust held 50% of the stock free of debt and borrowed to buy up the other half of the authorized stock. This debt was retired three years later.

We have since completed two major expansions with borrowings made economically possible by the partial interest exclusion for lenders that Congress now wants to tamper with.

These expansions have increased our personnel by more than 25 percent and today, our employees own a viable printing company with a net worth of some $5.2 million.

These lower-cost loans must continue to be available if capital appreciation is -to continue for participants in ESOPs.

We also strongly urge that the deductibility of dividends be continued. Dividends at Canterbury average 50 cents per hour for 10-year employees—proof that the plan benefits the participants. It is very doubtful that dividends would continue to be paid if they were not deductible.

The voting rights pass-through provision in Senator Bentsen's bill would accomplish little or nothing in those ESOPs where all, or a large percentage of the stock is owned by the trust. "If it ain't broke, don't try to fix it."

Congress must remember that the vast majority of ESOPs did not result from LB0's or bail-outs of foundering companies. We are honest, hard-working organizations whose people are learning the benefits of our capitalistic system. Don't paint us with that big brush meant for the few who violate the precepts of employee ownership.

Thank you for the opportunity to present our feelings on the matters at hand. We are enclosing 10 copies of this letter, five of which are for Mr. Ed Mihalski.

Sincerely,

DON C. MCLOUGHLIN, *Chairman/CEO.*

CONRAIL

Washington, DC, July 19, 1989.

Hon. BOB DOLE,
Senate Committee on Finance,
SH-141 Hart Office Building,
Washington, DC.

Dear Senator Dole: I am writing to you regarding a provision in the House Committee on Ways and Means revenue reconciliation proposal that generally would repeal the corporate tax deduction for dividends paid on securities held by an Employee Stock Ownership Plan ("ESOP") Section 404(k) of the Internal Revenue Code currently allows a deduction for such dividends. The Ways and Means proposal would eliminate the deduction except for companies with ESOPs holding at least 30% of the company's stock or ESOPs established before July 11, 1989.

Conrail is currently in the process of establishing an Employee Stock Ownership Plan which would provide 18.5% ownership to its employees. Due to specific provisions included in the 1986 Federal legislation authorizing sale of Conrail to private owners, Conrail was unable to complete adoption of its ESOP before July 11, 1987. Thus, the dividends paid on stock owned by Conrail's planned ESOP would not be deductible. This result would eliminate Conrail's ability to provide this benefit to its employees.

As you know, Conrail's common stock was held by the Federal Government until 1987, when the Government sold its interests through a public offering. Under the Conrail Privatization Act, Conrail is subject to various covenants, compliance of which is governed by the Department of Transportation. These covenants restrict dividend payments and limit the percent of Conrail's common stock that any one party may hold during the three-year period following the date of the public sale (April 2, 1987). The latter covenant has an exception for Conrail's then-existing employee stock ownership plan (which was terminated pursuant to the sale legislation) or any successor plan.

Beginning in April of this year, Conrail held a series of discussions with the Department of Transportation in order that DOT concur that the establishment of the Plan is in compliance with the Privatization Act covenants. Conrail is awaiting DOT concurrence and Conrail's management currently is scheduled to recommend to the Corporation's Board when it holds its regularly scheduled meeting on July 19, 1989, that the Board approve establishment of the Plan. This meeting and consideration of the ESOP were scheduled before July 11, 1989.

The ESOP dividend deduction was enacted in 1984 to facilitate employee ownership of stock. Repeal of the dividend deduction will make it significantly more expensive if not impossible to fund ESOPs—thereby depriving employees of this ownership opportunity and adversely prejudicing the use of ownership as an employee benefit in comparison with other deductible benefits. For this reason, Conrail urges the Senate Finance Committee not to amend or repeal the dividend paid deduction provision.

If the will of the Committee is to amend or repeal section 404(k), Conrail would request that transitional relief take into account its unique situation and its substantial reliance on existing law. We would be pleased to work with you and your staff on statutory language and have attached proposed language.

Thank you for your assistance.

Sincerely,

WILLIAM B. NEWMAN, JR.,
Vice President and Washington Counsel.

Attachment.

The Consolidated Rail Corporation ("Conrail") urges the Senate Finance Committee to reject efforts to repeal or substantially limit the deduction for dividends paid on stock owned by an Employee Stock Ownership Plan ("ESOP"). The House Com-

mittee on Ways and Means has approved such limits as part of this year's budget reconciliation bill.

- As part of a larger employee benefits package, ESOPs promote employee responsibility by giving employees a financial stake in corporate profitability.
  - ESOPs are not tax-shelters for the wealthy—the Internal Revenue Code's nondiscrimination rules ensure that all employees benefit.
- ESOPs are an important device in preventing dismemberment of corporations through hostile takeovers, transactions that recently have been of serious concern to the Congress.
  - Hostile takeovers result in personal upheaval for employees and loss of productivity while often economically resulting in little more than churning of corporate assets.
  - A recent Delaware court decision involving the Polaroid Corporation recognized ESOPs as an anti-takeover device.
- Employee compensation is deductible to corporations.
  - Dividends on ESOP stock either must be paid to the employees or used to repay stock acquisition debt; the stock is income to the employees when it is distributed by the ESOP.
  - Dividends paid on ESOP stock are paid to employees as a result of their employment relationship, these amounts are more appropriately viewed as compensation than as return on capital (i.e., investment earnings).
- Removal of the dividends paid deduction for ESOPs would impair the Nation's policy to improve its savings rate.
  - ESOPs provide employees an important means to increase both their' personal wealth and the Nation's store of investment capital.
  - Under existing law, the dividends paid deduction puts ESOP contributions on a par with other deductible forms of employee compensation.
  - If the dividends paid deduction and other incentives for ESOP formation are removed, employers will favor wages and other deductible benefits over the ESOP savings device as a method of employee compensation.
  - The result would be a reduced savings rate for employees.

Should the Committee on Finance decide to restrict the ESOP dividend deduction, notwithstanding Conrail's concerns, Conrail requests that the effective date of any restrictions recognize its unique circumstances.

- Conrail had an ESOP prior to the 1987 sale of the corporation by the Federal Government; the termination of that ESOP was mandated as part of the Federal legislation authorizing the sale.
- Unlike other Corporations, Conrail cannot establish a new ESOP before 1990, without Federal Government approval.
  - Specific provisions in the 1986 sale legislation precluded acquisition, before 1990, of more than 10 percent of Conrail stock by any one person.
  - An exception is provided for a "successor ESOP" to the terminated plan.
  - In April 1989, Conrail began negotiations with the Department of Transportation for a determination that the ESOP now planned is such a "successor."
- Pursuant to its negotiations with the Department of Transportation, Conrail scheduled consideration of the new ESOP at its regularly scheduled July 19, 1989, Board of Directors meeting; approval of the plan is anticipated at that meeting.

CHUBB CORP.

Warren, NJ, July 18, 1989.

Hon. LLOYD BENTSEN,
Senate Dirksen Office Building,
Washington, DC.

Re: S. 1171 and S. 1303

Dear Chairman Bentsen: The Senate Finance Committee is about to consider changes to the Internal Revenue Code in order to meet the current budgetary objectives. The House Ways and Means Committee, as is customary, is already well along in that process.

We are particularly concerned that the Finance Committee not adopt the Ways and Means Committee's proposal to repeal the dividend deduction with respect to employer securities held by an ESOP (Section 404(k)). ESOPs not only benefit smaller corporations where employees may have a significant percentage ownership but also larger corporations where the ownership participation may be proportionately

smaller, e.g. 5%. In both instances the objective is the same to enhance employee benefits and to promote greater employee participation as shareholders of their employer.

The Chubb Corporation, through its subsidiaries, is engaged in property and casualty insurance, life & health insurance and real estate development. It's domestic employee force numbers approximately 10,000. Here at Chubb we have been evaluating the possible integration of a defined contribution ESOP with our existing non-contributory defined benefit pension plan. Our purpose is to do everything we can within reasonable financial limits to help our employees position themselves to meet sound financial retirement objectives. We are actively considering a nominal ESOP that will add value to our long-term benefit/retirement program. To be economically feasible, it is essential that Section 404(k) remain intact.

We would like to move forward and hope that you will support our position and not delete the deductibility of shareholder's dividends as is now permitted by Section 404(k) of the Internal Revenue Code.

Sincerely,

ROBERT RUSIS, *Counsel.*

FOLLETT CORP.

Easton, PA, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
Washington, DC

Dear Ms. Wilcox: I am writing to hopefully have some influence on Senate bills S. 1303 and S. 1171, which are being heard by the Senate Finance Committee Subcommittees on Taxation and Private Retirement Plans.

Our company established an ESOP three years ago as part of an overall plan to transfer the ownership from the founding stock-holders to our employees. We are a manufacturer of commercial icemakers, dispensers, and storage bins used in the food service industry. This equipment industry is made up of over 1000 manufacturers doing over $5.0 billion in sales. This industry is made up of many small, privately owned companies.

As a past president of that trade association (NAFEM), I know many of these people and know the problems they are facing with ownership transition since our own situation is typical. Over the past 15 years there have been a number of these companies sold to the "megabillion" conglomerates—and their continued success has been almost nil. There are not many of these original companies still in existence. This is a tragedy for our industry and the future of American entrepreneurship!

The alternative to selling to a conglomerate is to sell to your employees. The advantages are many fold. Employees are now entrepreneurs! These companies become fierce competitors and continue to grow. This is what I want for our company.

By eliminating the original flexibility in ESOP financing, you reduce the possibilities of using ESOP's as a tool for ownership transition. What is magic about 30% ownership as a qualification for tax favorable financing? We want to make stock sales in smaller increments since our original stockholders want to make a gradual transition, not sell and leave at one time. Not only is this not a good personal transition, but it is also a high-risk business transition. We want this business to continue to grow in the future!

We realize why these bills are before you. Because of some abuses by Wall Street LBO'ers, a correction is needed. Why can't you deal with those abuses rather than destroy a concept that has such great benefits for promoting small company entrepreneurship?

Thank you for your consideration.

Yours very truly,

DON S. FOLLETT, *Chairman.*

STATEMENT OF KELSO & CO., NEW YORK, NY

Mr. Chairmen, during the seven years that I served as counsel to the Committee (1980–86), I worked closely with Senator Russell Long in the design of legislation

intended to encourage the expansion of capital ownership through the financing technique of employee stock ownership plans (ESOPs)

CAPITAL OWNERSHIP: JUDGE TAX POLICY BY ITS RESULTS

During that time, I learned that the best way to judge tax policy is by its results. Judging from the results, one must conclude that tax policy favors widespread home ownership. With the help of tax incentives, home equity now totals more than $3.5 trillion with almost two-thirds of American families living in owner-occupied housing.

Judging by the results, one could also conclude that tax policy favors widespread public and private pensions. With the help of government incentives, the total assets accumulated in public and private pension plans is now in excess of $2 trillion.

Similarly, judging by the results, one could also conclude that tax policy favors a very high concentration of capital ownership. According to a 1986 report by the General Accounting Office, except for the 22% of stock held in pension plans, 90% of all corporate stocks (and a similar percentage of bonds) are owned by just 10% of households, with more than 50% owned by just one percent of taxpayers. Every indication suggests that this wealth concentration is increasing at a rapid pace.

Tax policy favors this trend in many ways. For example, according to Internal Revenue Service figures, from 1975–1985, the two primary corporate tax benefits for capital financing (i.e., depreciation and the investment tax credit) total led $1,056,600,000,000. Given today's capital ownership pattern, approximately 50 of those tax benefits (i.e. $528.3 billion) were utilized to assist in the financing of *additional* income-producing assets for the already-wealthiest one percent of taxpayers. That trend continues.

ESOPS: OPENING TODAY'S "CLOSED SYSTEM" OF CAPITAL FINANCE

A fundamental financial maxim holds: "If you don't inherit it, you've got to borrow it." Those who do leveraged buyouts know this quite well. The secret of a leveraged buyout is simply common business practice: productive assets can pay for themselves and, thus, can repay debt incurred for their acquisition.

It is this same logic of "self financing" that ESOP financing aims to put to work to empower a broad base of Americans utilizing the employer's access to credit to finance employer stock in trust for employees.

ESOP financing recognizes (as tax policy as yet does not) that practically all corporate funds (whether for capital growth or for transfers in ownership) are provided through only three sources:

1. Retained earnings—which create no new capital owners,
2. Tax benefits (primarily depreciation)—which likewise create no new owners, and
3. Debt—which (except for LBOs and ESOP financing) creates no new owners.

Sales of new equities are not a significant source of capital and, since 1984, have been substantially negative due to the huge volume of stock buybacks (a net negative $130 billion for 1988 alone)—further concentrating ownership. And, of course, it is primarily those already within this "self financing" system who have the discretionary income (i.e., from their capital ownership) to be able to afford to purchase those few new equities.

The General Accounting Office examined this phenomenon (at Senator Long's request) and described it as a "closed system of finance." No matter how much capital is financed and no matter how much the capital base expands, the capital ownership base will remain constantly concentrated (or become more so) Most people understand that "the rich" do, in fact, "get richer." Focusing on this tax policy-fueled process reveals how.

THE FISCAL STRAINS OF CONCENTRATED CAPITAL OWNERSHIP

During 1989, the U.S. economy will finance $469 billion in new plant and equipment (according to Commerce Department projections). Between now and the year 2010, that means we can anticipate that the U.S. economy will undertake the financing of approximately $12 trillion in new plant and equipment—none of which is yet owned by anyone. Yet we know now, with certainty, that if tax policy continues to favor today's "closed system of finance," at least 50% of that $12 trillion will be financed for, at most, 2%–5% of the already-wealthiest U.S. households.

It will be a sad commentary on tax policy and a bitter irony indeed if, in this era of rapidly increasing wealth concentration (particularly via leveraged buyouts) this

Committee does anything other than *expand* on the incentives for expanding capital ownership. Cutting back on such incentives with the rationale of helping to balance the budget only makes the irony worse.

Continued tax policy support of today's "closed system" techniques of capital finance guarantee a continuing lack of widespread economic self sufficiency which, in turn, guarantees steadily worsening fiscal pressures. If we commit the fiscal folly of allowing the World War II "baby boom" generation to become an asset-poor "senior boom" (as current tax policy would do) the fiscal strains we face today will pale in comparison to those we will create for ourselves in the future.

If for no other reason than in the name of simple fiscal foresight and fundamental fairness, tax policy should be consciously, methodically and thoroughly designed to ensure *widespread* economic empowerment.

Otherwise, absent governmental intervention, market forces will continue to direct the bulk of income to those with the bulk of economic inputs (including those inputs represented by this nation's technological culture as embodied in our productive capital). It should come as no surprise that, as the ownership of those inputs (capital assets) becomes more highly concentrated (and as those capital assets displace labor skills in the production process), the concentration of income also becomes more concentrated.

NEEDED: AN UPSTREAM TAX POLICY

Thusfar, tax policy has tried to solve this nation's income distribution/purchasing power problem downstream of its source. When left with only their labor as their "input" with which to generate income in today's capital-intensive (and increasingly global) economy, is it any surprise that those left without capital ownership turn in increasing numbers to the government to redirect income that would otherwise flow to those who own that capital?

With a tax policy (and other government policies) coordinated to address the problem at its source (i.e., "upstream" at the level of capital ownership) government can begin to phase itself out of its dominant role as income re-director.

The ESOP financing concept suggests that if we truly intend to have a market economy (i.e., in which income is based on economic inputs) current tax policy undermines that intent by favoring capital financing techniques that build so many economic inputs (capital assets) into so few households while leaving so many with only their labor as their sole "input" with which to generate income.

The ESOP financing concept addresses the two heretofore unsolvable problems facing those who favor widespread capital ownership over concentrated ownership: (1) how to make investors of those without funds to invest, and (2) how to achieve a broader distribution of wealth (i.e., input-ownership) without redistributing wealth.

Widespread access to capital ownership is a function of encouraging widespread access to the credit necessary to acquire those assets—thus the nature of the tax incentives designed to encourage ESOP financing. Of course, the debt incurred to finance those assets will, over time, become equity (i.e., as the debt is repaid)—thereby transforming that debt into a long-term source of savings (and income) for a widespread group of taxpayers.

COMMENTS ON THE PENDING LEGISLATION

Rather than summarize the many reasons for supporting ESOP financing as the most accessible and practical way to expand capital ownership (and ways in which tax policy could be adapted to promote that goal) let me instead summarize several comments concerning certain ESOP legislation pending before the Committee (i.e., S. 1303, S. 1171 and various proposals under consideration by the House Ways and Means Committee)

Why a 30% (or a 50%) Requirement is a Bad Idea

- Often mathematically impossible:

—Because the ESOP tax benefit is based on a percentage of payroll (i.e., 25% of payroll), ESOP contribution limits will make it difficult (and often impossible) to finance a 30% stake in capital-intensive companies.

—For example, a $200 million company with a $20 million payroll could contribute only $5 million per year to its ESOP (i.e., 25% of payroll).

—Effectively precludes the use of ESOP financing in the bulk of public companies.

- Lesser amounts often represent a significant ownership stake:

—For a company to agree to an ESOP for the acquisition of even 5%–10% of a company's stock can represent an enormous commitment, particularly in a large, publicly-traded company.
—Even Lowe's Company or Ashland Oil, both with ESOPs holding more than 20% of the stock, would be considered "bad" ESOPs under these approaches.
—Few public companies have single shareholders with more than a 5–10% stake.
—The research indicates that what counts as "significant" to employees is the size of their individual account balances and how much is being contributed each year—which quite often can be achieved with an ESOP acquisition of much less than 30%.
—An employee ownership stake at far lesser levels can be a key component of a large, public corporation's employee benefits and corporate culture—and (as the research shows) contribute to corporate performance.

• May limit ability to fund other employee benefit plans:

—ESOP contributions can reduce amounts employers are permitted to contribute to other benefit plans.
—Requiring an unrealistically high minimum level ESOP may cause employers to scale back other employee benefit plans.

• Expense could be prohibitive:

—Requiring a company to borrow 30% of its value may weaken the company and endanger employees' stock value.
—Problem is exacerbated in public companies where ESOPs are generally established in conjunction with stock buybacks to minimize dilution of other shareholders.

• Imposes too dramatic a first step requirement:

—Violates commonsense notion of allowing companies to phase in employee ownership, step-by-step.
—Requiring the transfer to employees of a "control block" at the outset is too extreme.

• Lender concerns re management continuity:

—A 30% stake can represent a control block.
—Lenders look not only to collateral and cash flow but also to management continuity—an essential element of "bankability" yet an element jeopardized by a high minimum threshold.

• Approach has no support among those it hopes to help:

—Existing ESOP legislation has no threshold requirement (except for the "ESOP rollover" where the policy analogy was to the tax-free exchange provisions which require a substantial change in ownership).
—ESOP Association membership's average ESOP ownership is less than 30%.
—Even those unions that support a 30% threshold acknowledge that even that level is often difficult to achieve, particularly where "givebacks" are a part of the negotiation that leads to an ESOP.

• A 50% threshold requirement (as in S. 1171) is even worse:

—So-called "majority ESOPs" are the rarest of all ESOPs and appear most commonly in distressed companies, often reflecting the company's inability to attract outside equity (i.e., because of the high risk/low return perception of such companies)
—This employee control, "corporate democracy" model should be embraced voluntarily by those who agree with it, not imposed by Federal law.

• A 30% (or 50%) stake could restrict market liquidity.

WHY FURTHER EXPANSION OF PASS-THROUGH VOTING IS A BAD IDEA

• Pass-through voting is already required:

—In publicly-traded companies, current law requires pass-through voting on all issues.
—In non-public companies, pass-through voting is required on major issues (i.e., "with respect to the approval or disapproval of any corporate merger or consolidation, recapitalization, reclassification, dissolution, sale of substantially all

assets of a trade or business, or such similar transaction as the Secretary may prescribe").

—Principal remaining issue is voting for board of directors. Approximately 25% of non-public ESOPs elect to provide pass-through voting on all issues.

—Voting is otherwise required to be exercised by a fiduciary who must "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries for the exclusive purpose of providing benefits to participants." The full range of equitable remedies are available for any breach of this duty.

• An idea whose time has not come:

—The highly touted employee involvement book, *Working Together* (co-authored by the founder of the Association for Workplace Democracy) concludes its analysis of pass-through voting on ESOPs: "Unquestionably, the requirement of passing through the vote to the individual stockholder has made many companies shy away from this first step in increased employee participation in ownership."

—The 1985 book, *Employee Ownership in America* (by the founder of the National Center for Employee Ownership) concludes: "Employees of companies that offer full voting rights are not significantly more satisfied than employees in companies that do not offer full voting rights. This too is not such a surprising result upon closer inspection. In most companies, voting rights are more symbolic than important."

—A 1985 survey by the National Center for Employee Ownership concludes: "Apparently workers were much more concerned with the actual influence they have in a company than in the formal, often purely symbolic, power that voting rights confer." (Conclusions based on 140-item survey of over 3500 employees plus 50 case studies concerning employee attitudes regarding employee ownership).

—A 1981 survey of 228 ESOP companies (by the Journal of Corporation Law at the University of Iowa) concludes: "The survey results do not reveal a relationship between voting rights and improved productivity; therefore, the new voting rights requirements may, unjustifiably, compel changes in existing ESOPs and serve as a deterrent for companies that are considering the adoption of an ESOP." Note: the original 1978 Treasury rationale for urging pass-through voting was to positively impact productivity. A Treasury-promised study on this issue never materialized (though it was legislatively mandated for completion in 1979).

• Serves as a chilling effect on implementation of ESOPs.

—How many employees have already been "protected" out of owning any employer stock at all?

—How will we ever know how many companies (due to the existing voting requirements):

did not establish ESOPs,
established other plans instead,
terminated their ESOPs,
stopped acquiring stock in their ESOPs, or
reduced the amount of stock they would otherwise have acquired?

—In 1988, the U.S. economy undertook $741 billion in capital financing:

$311 billion in mergers and acquisitions (via 3,637 transactions) plus
$430 billion in new plant and equipment
Yet less than $6 billion (1%) was financed via ESOPs
More pass-through voting can only further reduce that already small amount

—ESOPs are already over-regulated:

Both the IRS and the DOL are required to give ESOPs "special scrutiny."
ESOP companies are almost assured of an IRS audit.

—Lenders concerns would be increased:

ESOPs are designed as a technique of corporate finance: encouraging companies to borrow funds to buy company stock for employees.
Lenders look not only to collateral and cash flow but also to management continuity—an element jeopardized by increased pass-through voting.

—Research indicates that what employees want most from their ESOP is a large account balance—an employee preference endangered by expanding the re-

quirements in pass-through voting (i.e., because the increasing size of employees' ESOP accounts would begin to shift the balance of in the company).

- Singling out ESOPs is irrational and can harm employees:

—For example, a profit-sharing plan that is 100% invested in employer stock has no pass-through voting requirement.
—Thus, an employer for whom pass-through voting is a concern can instead implement a profit-sharing plan and simply contribute employer stock each year and claim a tax deduction for its value.

That contribution could "tax shelter" principal payments on a conventional loan,
The employer can thereby claim a similar amount of tax deductions,
The shareholders suffer less dilution (because it takes less stock to generate the same tax deduction as share values rise) and
The cost to the treasury is the same, and
Because the company is not committed at the outset to a specified amount of contributions (as with a leveraged ESOP) the sponsoring company can terminate or reduce its future contributions.
Meanwhile, employees would:

miss out on the advantage of the ESOP leverage and, thus,
receive less stock per dollar of tax cost to the treasury,
receive less stock if, due to their efforts, the stock increases in value, and
have NO pass-through voting.

- Misses the point about what ESOPs are really about:

—The principal purpose of ESOPs is to encourage the use of an ownership-expanding technique of finance that can make it possible for more Americans to have an ownership income (from their ESOP-financed capital) to supplement their labor income (thus the dividend deduction for ESOP-held shares)
—The ESOP financing concept is not an attempt to impose Scandinavian-style "codetermination" management structures or "co-op" type corporate governance (i.e., one-man-one-vote). The ESOP legislation is designed to accommodate those who wish to implement those management styles—but is not intended to force ESOP companies to utilize those management styles.
—"Industrial Democracy" is an idea that can be implemented as part of ESOP financing; the danger lies in requiring it (e.g., by requiring the acquisition of a control voting block for employees).
—The current level of pass-through voting recognizes that those who built and control closely-held companies have other financing alternatives available to them and that ESOP financing must be sufficiently attractive (including from the control perspective) that those who can choose or reject the ESOP will find it attractive relative to other alternatives.
—Given the still relatively scant number of ESOPs nationwide, the evidence suggests that ESOP financing is not yet attractive enough. Expanding the pass-through voting requirements makes ESOP financing an even less attractive alternative.

- Confuses "employee involvement" with voting:

—"EI" (employee involvement") and "employee participation" are excellent ideas, and ideas embraced by foresighted mangers nationwide. Employee involvement is rapidly becoming recognized for what it is: simply good human relations. For example, according to a 1989 Wyatt Company survey:
36% of companies now consider themselves to be moving toward more participative work places, up from 18% just three years ago.
50% of managers now report that they are paying attention to employee input to help make decisions, as well as to prevent problems rather than react to them.
One in four companies seeks out employee opinion before making major policy decisions and a similar percentage go to employees before implementing decisions.

—The challenge is how to create a workplace environment in which such employee involvement is likely to emerge:

Tom Peters (co-author of *In Search of Excellence*) identifies "a shared sense of values" as the most important ingredient in the elusive recipe for successful companies.

A shared sense of ownership can help create that environment—out of which employee involvement is more likely to emerge. Peters is now a vocal ESOP advocate.

Employee involvement is a good idea regardless of whether or not a company has an ESOP.

Employee involvement and ESOP are a great combination and both are desirable alone.

Requiring employee involvement as part of an ESOP may well ensure that the employer adopts neither employee involvement nor ESOP.

Legislatively *requiring employee involvement is impossible—given the vast variety of different workplace environments.*

Yet by encouraging ESOPs, tax policy can help create an environment receptive to employee involvement.

• How the Committee can employees with ESOP voting:

—In an ESOP with pass-through voting, provide protection to an ESOP fiduciary when he votes all ESOP-held shares in accordance with the wishes of plan participants (as approved by the Banking Committee in the Tender Offer Disclosure and Fairness Act of 1987).

—Thus, if a trustee votes unallocated ESOP stock in proportion to the employees' vote on allocated stock (for example, on whether to tender ESOP-held shares) the trustee would be insulated against any challenge to the proper exercise of his fiduciary duty.

WHY A 15-YEAR MAXIMUM TERM ON ESOP LOANS IS A BAD IDEA

• May simply limit the level of employee ownership achievable through ESOP financing.

—For example, AVIS is an 87% ESOP-owned company financed via a 25-year ESOP loan.

—The ESOP is funded at approximately 22% (vs. 25%) of payroll in order that the company could continue its 3% 401(k) plan.

—Limiting the AVIS ESOP to a 15-year term would have meant that the ESOP could acquire 40% less stock (i.e., via 15-year instead of a 25-year term loan) How does that help employees?

WHY DISALLOWING PUBLICLY TRADED ESOP DEBT IS A BAD IDEA

—Repealing I.R.S. Revenue Ruling 89-76 (relating to publicly traded ESOP debt) runs counter to the policy it professes to promote.

—Inssuance of this June 2d ruling was followed by the introduction of legislation on June 6th to repeal I.R.C. Section 133 along with rhetoric railing at banks and investment bankers.

—The concern expressed was that the tax benefit provided to ESOP lenders was not being sufficiently "flowed through" to ESOP borrowers, a concern belied by the statistics showing substantial competition among ESOP lenders—reflected in substantially lower interest rates on ESOP debt versus conventional debt.

—Competition among qualified lenders (enhanced by permitting the public trading of ESOP debt) can only improve market efficiency and competition, thereby further improving the interest rates available to ESOP borrowers and thereby making ESOP financing more attractive relative to conventional financing.

WHY A 30% MINIMUM FOR ESOP DIVIDEND DEDUCTION IS A BAD IDEA

• Regardless of the percentage of stock held by an ESOP, the dividend deduction directly benefits employees: either by cash dividends paid to employees as current income or by accelerating the transfer of stock to employees through repayment of an ESOP loan.

• The beneficial effects of encouraging a current pay out of ESOP dividends to employees include the following:

—Implements the core ESOP concept of generating an ownership income for employees to supplement their labor income.

—Encourages employers to share with their employees more of the economic benefits of corporate performance.

—Encourages a current pay out of the earnings on capital (versus the traditional approach of retaining the earnings and hoping that retention will be realized later as capital gain)
—Promotes a widespread capital-based source of purchasing power and, because ESOP dividends are currently taxable to employees, enhances Federal and state tax revenues.

• The beneficial effects of allowing ESOP dividends to be used to repay ESOP debt include the following:

—Enables ESOP-sponsor companies to accelerate ESOP debt repayment, thereby saving interest expense while simultaneously accelerating employees' stock accumulation (and the potential for dividend income).
—Encourages the use of convertible preferred stock—paying higher dividends, offering the highest voting power and convertible to common stock at a predetermined conversion price—thereby providing greater security to employees. Preferred stock is the ESOP security preferred by employees in ESOPs negotiated under collective bargaining.

• Because an ESOP dividend payment is not counted toward the individual allocation limits under I.R.C. Section 415 (i.e., as a plan contribution), the dividend deduction enables ESOP sponsors to maintain other employee benefit plans while also sponsoring a significant ESOP.
• Eliminates the double taxation of dividends to the extent that capital ownership becomes more widespread (with 46% of those dividends paid to individuals being paid to 1% of households, the "integration" of corporate and individual income taxes is hardly a grassroots issue).

MODEST STEMS THE COMMITTEE COULD TAKE TO ENCOURAGE ESOPS INCLUDE:

• Extend the I.R.C. Section 72(t) exception allowing ESOP distributions to be distinguished from retirement plan distributions by permitting them to be exempt from the 10% early distribution excise tax on distributions prior to age 59½.

—Distinguishes conventional retirement plans from ESOPs (i.e., as a technique of capital finance operating through an employee benefit plan to acquire employer stock and to provide a current capital-source income).
—Enhances employees' economic mobility—e.g., by enabling them to leave their employer and apply their ESOP-financed capital accumulation to some other purpose (e.g., starting a new business).

• Restore the I.R.C. Section 4980(c) (3) provision allowing the tax-free transfer to an ESOP of excess pension plan assets.

—Offers a compromise solution to the question, "Whose money is it?" by (a) enabling employees to retain the benefit of the excess assets (i.e., in the form of employer stock) while (b) permitting employers to recover the excess cash (i.e., provided they use the funds to buy treasury shares).
—This approach can provide the equity to enable employees to participate in a leveraged buyout (LBO) in which they might otherwise be left out. For example, in the 1988 LBO of American Standard in which Kelso & Company acted as a "white knight" in fending off a hostile bid by Black & Decker, $50 million in excess pension assets transferred tax-free to the ESOP acquired for 7,000 of American Standard's U.S. employees a 19% stake in a $3 billion transaction involving a multinational corporation employing 35,000. In most LBOs, those excess assets are instead simply recovered by the company (less a 15% excise tax), with a portion often bonused to executives to finance their equity.

• Additional approaches summarized in "Testimony before the Committee on Ways and Means concerning leveraged buyouts" (March 15, 1989).

LUKENS, INC.

Coatesville, Pa, August 8, 1989.

Senator SPARK MATSUNAGA, *Chairman,*
Senator DAVID PRYOR, *Chairman,*
Finance Committee Subcommittees,
Taxation and Debt Management,
Private Retirement Plans and Oversight of the Internal Revenue Service

Dear Mr. Chairman: The following testimony is submitted regarding legislation being considered affecting employee stock ownership plans (ESOPs). This legislation includes S. 1303, S. 1171 and ESOP provisions likely to be reported out of the House Ways and Means Committee in its markup of revenue reconciliation provisions.

We are opposed to repeal of the Section 404(k) dividend deduction and repeal of Section 133, which allows a partial exclusion for interest on ESOP loans.

Many ESOPs today meet the overall goals designed by Congress: broaden stock ownership by employees, provide retirement income opportunities for workers and provide capital for business investment. Tax code changes being considered in the Senate and by the House Ways and Means Committee, if enacted, will have a prohibitive effect on the creation or continuation of ESOPs by employers. Retroactive changes, such as the effective date of June 6, 1989 proposed in H.R. 4052, S. 1303 and S. 1171, caught many corporations such as Lukens by surprise. We have invested substantial resources in developing an ESOP for our employees and at June 6, 1989 were within a few weeks of establishing our new plan, effective June 29, 1989, with stock purchase on June 30, 1989.

As is the case with most companies, Lukens is constantly seeking ways to improve performance. One method is to ensure that its employees are committed to the success of the business. This commitment is encouraged in part by providing an attractive compensation package, including provisions for long term security, and by permitting them to share in the success and growth of the business.

Management believes that employee stock ownership of up to approximately 12% will provide not only added future retirement security but presents added incentive to increased productivity and improved quality through pride in ownership.

The ESOP loan is for approximately $33 million and the term of the loan is 11 years. Lukens has issued to the ESOP preferred stock which pays an 8% dividend and is convertible into Lukens common stock. The Company will contribute $1.50 for each $1.00 the employee contributes to the Plan, up to a maximum of 4.5% of the employee's base pay (150% of the first 3% saved by the employee). The dividends and the matching contributions by Lukens will amortize the loan to the ESOP and thus allow preferred stock to be allocated to employees.

The ESOP stock carries voting rights which enable the employee to direct the trustee to vote the shares allocated in his/her account. Unallocated shares are voted in the same proportion as ESOP Plan participants elect to have their allocated shares voted.

The preferred stock allocated to the employee is always fully vested. The employee is entitled to 1000 of his/her account balance upon leaving the Company for any reason.

Lukens urges Congress to develop measures that encourage employers to provide corporate benefit programs for the well-being of the employee, the employer and the economy as long as the cost of such programs does not make American industry uncompetitive in world markets.

We ask the panels not to vote to repeal Section 404(k) pertaining to dividend deduction and Section 133 allowing a partial interest exclusion to ESOP lenders.

We also ask that this testimony be made a part of the Record.

We look forward to the opportunity to work with you on this legislative issue to reach a mutually acceptable arrangement.

Respectfully submitted,

WILLIAM D. SPRAGUE.

MASSMUTUAL

Springfield, MA, August 8, 1989.

Hon. DAVID PRYOR,
Committee on Finance,
Subcommittee on IRS Oversight and Qualified Retirement Plans,
Dirksen Senate Office Building,
Washington, DC.

Dear Senator Pryor: Massachusetts Mutual Life Insurance Company ("MassMutual") would like to take this opportunity to provide a written statement for the hearing record of the July 19, 1989 Subcommittee hearing on retiree health funding and express our views on incentives to prefund retiree health benefits.

MassMutual has a strong interest in matters affecting retirement security, in that we provide a full range of actuarial, administrative, investment and professional services to over 5,000 retirement plans. In addition to providing significant pension

services, MassMutual is the nation's 17th largest commercial health insurance provider.

MassMutual believes that allowing employers to withdraw excess assets from defined benefit pension plans to fund retiree health obligations is a positive step that will enhance retirement security for many present and future retirees. As you know, retiree health plans are typically funded on a pay-as-you-go basis, which has resulted in a low level of retiree health benefit security for persons covered under such plans. The transfer of assets will allow many employers to more adequately fund retiree health plans, and maintain such plans in the face of ever-increasing health care costs.

However, allowing for the transfer of assets to retiree health plans should only be considered a first step toward addressing the need to prefund retiree health plans. For retiree health plans to provide the greatest security for today's workers and retirees, a broader range of tax incentives are needed. Mass Mutual supports expanding Code Section 401(h) to allow for higher deductible contributions to retiree health plans. The prefunding incentives of S. 812, the Retiree Health Benefit Preservation Act, exemplify the incentives necessary to more completely address the need to prefund retiree health benefits. For sound policy reasons, the Committee should include increased incentives as part of its tax bill.

Another important aspect of asset transfers is the effect that such transfers would have on benefit security for plan participants. We agree with the position of the Department of Labor (expressed at the June 14, 1989, Ways and Means Oversight Committee hearing on retiree health benefits) that any legislation allowing the transfer of assets from defined benefit plans should ensure that such transfers do not jeopardize or diminish the security of pension benefits. Since allowing asset transfers from ongoing plans would be a significant expansion of current law, the requirement that benefits owed to participants be fully vested and annuitized at the time of transfer is a sensible way to protect the retirement income security of plan participants. This requirement is analogous to the current law requirements for vesting aid annuitization at the time of plan termination.

Annuitization will provide a plan participant with a benefit fully guaranteed by a life insurance company without risks arising from the future health of the employee benefit plan or the employer sponsoring the plan. Annuitization might be a mandatory condition of the asset transfer. Annuitization might also be a voluntary decision by the employer. The plan investment fiduciary could either retain investment discretion for plan assets with a high cushion (say, 150% of current liability) or the plan could purchase fully guaranteed annuities with a lower cushion (say 120% of plan current liability).

We look forward to working with the Committee on this issue.

Sincerely,

JOHN M. NAUGHTON, *Executive Vice President.*

MORGAN STANLEY

New York, NY, July 17, 1989.

Senator ROBERT DOLE,
Office of the Republican Leader,
Room 5230,
Capitol Building,
Washington, DC

Dear Senator Dole: As you are aware, tax incentives for leveraged ESOPs are being reexamined because of concern that they have become too attractive or are being abused. The basic concept of a leveraged ESOP is to purchase employer securities to be allocated as retirement benefits to employees over the next several years. Most employees will hold these securities until retirement, building a nest egg to supplement social security and defined benefit pension plans. The concept of employee ownership has had broad support for many years as a way to provide equity ownership to the average American and as incentives to improve motivation, productivity, savings and international competitiveness.

Over the last year ESOPs have finally become an accepted employee benefit tool by many major public companies resulting in over $12 billion of leveraged ESOPs in the first half of 1989. This rate of ESOP creation has caused Congress to consider restricting or eliminating two ESOP tax incentives.

1. Section 133 which allows a 50% exclusion on interest earned on ESOP loans by qualified lenders (banks and insurance companies).
2. Section 404K which provides a tax deduction when dividends on ESOP securities are used to service ESOP debt or paid out directly to employees.

The logic behind Section 133 was that lenders would pass thru their tax savings in the form of lower borrowing costs to stimulate ESOP creation. For Section 404K, dividends are used to help fund a benefit expense which would otherwise be funded by tax deductible employer contributions or if paid out to employees, create current income taxes for the employee.

On June 7, 1989, Chairman Dan Rostenkowski of the House Ways and Means Committee proposed eliminating Section 133 with an immediate effective date. A similar bill with the same effective date was introduced to the Senate on June 13, 1989, by Senator Robert Dole. Even with these proposals in place many companies continued to find ESOPs an attractive employee benefit and over $5 billion in additional transactions were announced under concern that further action would occur to limit ESOPs when the Ways and Means Committee mark-up began on July 10, 1989. On that date Chairman Rostenkowski added an amendment to eliminate Section 404K. His analysis at that time indicated that the elimination of Section 133 would raise $10.2 billion in taxes over the next five years while eliminating Section 404K would raise an additional $3.0 billion over the same time period.

During the same week amendments were added to the Ways and Means proposal by Congressman Schultz to make the effective date on the elimination of Section 133 to July 10, 1989, and by Congressman Anthony to keep both Sections 133 and 404K for ESOPs that owned at least 30% of a company. At the same time Senator Bentsen introduced a bill into the Senate to restrict Section 133 to ESOPs owning 30% or more of a company with an effective date of June 6, 1989, while leaving Section 404K in place.

We believe the Senate proposals by Senators Bentsen and Dole are the fairest and will raise the greatest amount of revenue while still keeping some incentives for large public companies to broaden employee ownership. Section 133 limited ESOP borrowing to only banks and insurance companies which are a relatively small part of the worldwide capital markets. With the large demand for ESOP debt the lenders were keeping most of the tax advantages for themselves and not passing them thru to the employee trust. From the over $5 billion in transactions announced between June 6 and July 10, it is clear that companies were prepared to continue to do leveraged ESOPs without Section 133. Given the history in Congress of keeping effective dates on tax bills, the Schultz Amendment gives a windfall to lenders and to companies aware of the proposed bill but willing to proceed anyhow. It is estimated that the five-year revenue loss on the change in the effective date may be greater than the cost of keeping 404K in place.

The Senate bill is much fairer because it keeps the effective date as announced and because it continues the 404K incentive (which is less costly). This combination still provides transition relief for many other companies which were well along the way to establishing ESOPs having spent much time and money but which were not ready to announce the program to employees by July 10 and those that had announced transactions after June 6 but had not yet arranged financing under the assumptions that Section 133 would be eliminated.

In considering continuation of incentives for leveraged ESOPs some other misconceptions should be addressed. Although some ESOPs were seen as defensive anti-takeover tactics, most ESOPs were done primarily as a way of increasing employee benefits and providing incentives for increased productivity. Of 49 transactions over 50 million done in the last year, 38 represented 10% or less of a company's stock—an amount which should not serve as an effective anti-takeover tool. Only two of these transactions created ESOPs owing more than 15%. In addition, almost every one of these large transactions used ESOP benefits as a supplement to and not a replacement of defined benefit pension plans. Also the majority of companies passed the ESOP tax incentives through to employees by creating a better level of retirement benefits.

In summary, we believe employee ownership is an important economic initiative which can broaden capital ownership in America. For 1983, 58.4% of common stock in the U.S. was owned by less than 1% of the population. Broadening ownership to the average worker should enhance retirement savings, motivation, productivity and international competitiveness. However, it is important to keep a proper balance of tax incentives. It should be clear that the current Senate proposal to restrict Section 133 which provided lenders tax benefits but to keep Section 404K which still provides some corporate incentives is a fair solution. Also, keeping a June 6, 1989, effective for this transition is most fair. There is no need to provide a windfall to

lenders while taking the remaining incentive away from companies continuing to formulate plans.

We hope you agree with our views and will act in Congress to support what we believe is a fair balance. Thank you.

Sincerely yours,

PAUL J. MAZZILLI, *Principal.*

MORGAN STANLEY,
New York, NY, August 23, 1989.

Senator ROBERT DOLE,
Office of the Republican Leader,
Room 5230 Capitol Building,
Washington, DC.

Dear Senator Dole: There has been some misunderstanding regarding comments in my July 17, 1989 letter to you concerning ESOP tax incentives. As you will recall, we are in support of the provisions in your bill S. 1171 and Senator Bentsen's bill S. 1303 which would restrict section 133 which allows the 50% tax exclusion to qualified ESOP lenders while maintaining section 404(K) which provides a tax deduction on dividends used to service ESOP debt. It was our opinion that this combination would retain some incentives for corporations to continue to create employee ownership.

In my letter, there was a reference to the Schultz amendment to the House Ways and Means package providing a "windfall" to some companies and lenders by changing the effective date of proposed legislation from June 6 to July 10, 1989. This was in reference to a number of ESOPs that were announced between June 6 and July 10 by companies which were aware of proposed restrictions to Section 133 but willing to proceed in order to keep the section 404(K) incentive which was not questioned until July 10. As you are aware, there are many ESOPs which were announced prior to June 6, but which could not be completed and closed until late June. These companies would be provided fair transition relief and not a windfall under the Schultz amendment.

To clarify our opinion, the implementation of an ESOP takes many months of planning and involves multiple capital markets transactions which take time to execute. We believe companies which made decisions to create an ESOP should be provided transition relief based on the rules in place at the time the decision was made. Therefore, even though we feel that the Senate bills are a fair solution going forward, we believe liberal transition rules should be allowed. In particular, companies which made decisions at the board level and announced transactions should be provided transition relief as of June 6 for any changes in Section 133 and as of July 10 for any possible changes in Section 404(K).

Thank you for your consideration of this additional information.

Sincerely yours,

PAUL J. MAZZILLI, *Principal.*

STATEMENT OF PENSION RIGHTS CENTER, WASHINGTON, DC

COMMENTS ON PROPOSAL TO PERMIT TAX FREE TRANSFERS OF "SURPLUS" PENSION MONEY TO RETIREE HEALTH ACCOUNTS

A proposal now pending before Congress would encourage companies to use so-called "surplus" pension money to pay for health benefits promised to retirees. Although the proposal appears to be geared toward retirees' interests, it actually would hurt the very group it purports to help. The proposal is also inadequate to protect the ongoing benefits of active workers under pension plans.

The original proposal was developed by a group called the Coalition for Retirement Income Security (CRIS) made up of the nation's largest corporations, including AT&T, W.R. Grace and IBM. It has been incorporated in modified form into proposed legislation passed by the Ways and Means Committee.

The proposal has been included in the Ways and Means Committee budget package solely because it would produce a short-term revenue "gain." According to the proposal's sponsors, Federal tax revenues would increase in the next two years because the money companies would use to pay their retiree health insurance premiums would come from pension plans rather than from corporate assets. This would mean that companies would not deduct the money paid for retiree health benefits as

business expenses from their income taxes. After the two year period, the gain would diminish and then disappear.

THE PROPOSAL WOULD ENCOURAGE COMPANIES TO STRIP NOW-HEALTHY PENSION PLANS DOWN TO A FUNDING LEVEL THAT WOULD LEAVE NO MONEY TO PROVIDE NEEDED PENSION INCREASES TO RETIREES. While private pension plans are not required to provide cost of living adjustments to retirees, most of the large companies supporting the proposal typically provide voluntary increases in retirees' benefits out of "surplus" assets. These ad hoc adjustments reflect the fact that the same inflation that helped increase the value of pension plan portfolios, simultaneously decimated the purchasing power of retirees' pensions. Were the "surplus" to be siphoned out of these pension plans, the retirees' hope for adequate pensions would disappear.

THE PROPOSAL WOULD TAKE MONEY THAT COULD GO TO INCREASE THE PENSION BENEFITS OF THE OLDEST AND NEEDIEST RETIREES AND USE IT TO PAY FOR HEALTH BENEFITS FOR THE YOUNGEST AND BEST-OFF RETIREES. Voluntary cost of living adjustments paid out of "surplus" pension money help restore the purchasing power of inflation-eroded benefits of older retirees. The money transferred into retiree health accounts would primarily be used for early retirees, since the health costs of older retirees are largely paid by Medicare.

THE PROPOSAL WOULD USE THE PENSION MONEY OF ALL RETIREES TO SUBSIDIZE THE HEALTH BENEFITS OF ONLY SOME RETIREES. Health benefits are only paid to the relatively small proportion of retirees fortunate enough to be working for an employer at early retirement age. Those who are laid off, or whose division is sold before that age, do not receive health benefits. It is unfair to use the pension money of all retirees to subsidize health care costs of only some retirees.

THE PROPOSAL PROVIDES NO ASSURANCE THAT HEALTH BENEFITS WOULD NOT BE REDUCED OR CANCELED AFTER THE MONEY HAS BEEN TRANSFERRED. The proposal would permit money that could be used to increase the buying power of pensions to be exchanged for a tenuous retiree health promise that is not guaranteed. There is nothing in the proposal to prevent employers from reducing or eliminating health benefits promised to retirees.

THE PROPOSAL WOULD ENCOURAGE EMPLOYERS TO TAKE OUT MONEY THAT IS NEEDED TO FUND THE BENEFITS OF ACTIVE WORKERS. The proposal passed by the Ways and Means Committee would permit companies to use all money in a plan above 140% of current liabilities" to pay for retiree health benefits. According to a recent survey of Fortune 1000 plans, roughly one-fourth have projected benefit obligations of more than 140% of current liabilities. Stripping those plans down to a 140% cushion, would leave them underfunded on an ongoing basis.

THE PROPOSAL WOULD ENCOURAGE EMPLOYERS WHO HAVE NOT TAKEN REVERSIONS TO SIPHON MONEY OUT OF PENSION PLANS. Many of the largest corporations have not "raided" their pension plans because of labor or public relations considerations. These constraints would disappear were Congress to legitimize tax-free transfers of "surplus" pension money to pay for retiree health insurance benefits.

THE PROPOSAL WOULD NOT BAR RAIDS ON PENSION PLANS FOR OTHER PURPOSES. The proposal would permit the continuation of current rules that allow companies to cancel or restructure plans in order to use pension money for leveraged buyouts, takeovers and other corporate purposes. These rules require only that companies pay a 15% excise tax on the money taken out of the plan, and buy annuities from life insurance companies to pay workers and retirees benefits.

SENATE FINANCE COMMITTEE: RESPONSES TO COMMITTEE PRESS RELEASE

ADAM METAL SUPPLY, INC.,
Elizabeth, NJ, July 18, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee SD-215,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171 and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcom-

mittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Our company, Adam Metal Supply, Inc., has a seven year old 50% ESOP which undoubtedly kept this company alive back in 1982. It has been a very successful vehicle for hiring and motivating employees perhaps not all—but most employees, particularly key employees from the clerical to management levels of the company.

Our ESOP is the pension plan for our company (a second pension for our unionized employees at a lower participation) and many individuals have left or retired either fully or partially vested with ESOP payouts between $10,000 and $70,000 in six short years time. Currently there are a number of individuals with ESOP accounts valued at $60,000.00 to $80,000.00 (these are not executive management!) Don't try to tell them that it hasn't been a successful experience and pension benefit plan!

As you consider tampering with the laws and regulations governing ESOP's, we strongly urge you *not* to weaken the incentives which have led to the creation of so many ESOP plans—particularly in closely held companies. We specifically urge you *not* to support changes being presented in S.1303—and most specifically the requirement that closely held companies be required to pass all voting rights through to employees.

ESOP's are successful vehicles for motivating employees and giving them the opportunity to share in the equity growth of their own companies through ownership—an incredibly sound American principle and concept! However, it does *not* follow that they are immediately qualified managers or directors with the ability to determine a company s future, etc. I for one would not have chosen the ESOP vehicle to finance the purchase and motivate my employees if I had had to pass through all voting rights.

We strongly oppose this pass through of voting rights in any new legislation.

Your accepting our comments are appreciated.

Sincerely yours,

A.P. LeClair, Jr., *Chairman, C.E.O.*

Allied Incorporated,
Ann Arbor, MI, July 20, 1989.

Ms. Laura Wilcox,
Hearing Administrator,
Senate Finance Committee SD-215,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Allied, Inc., an Ann Arbor, Michigan based company, with over 200 employees is becoming an Employee Stock owned company. In 1988 30% of the stock was placed in a Trust to be distributed to the employees over the next 7 years. My future plan is to be able to walk away from the business and leave it in the hands of the employees who have helped make us what we are today. I do not wish to sell the company to an outside concern who could possibly strip the company and its assets or get rid of our loyal employee base who have helped us grow over the years. The ESOP as it exists in it's present form allows me to realize this dream.

Several issues which are currently before the Senate, if passed, would prevent me from continuing with my future ESOP plan. (1) If the Senate repeals the ESOP lender partial in-trust exclusion leveraged ESOPs as we know them would be difficult to obtain and afford in the future. Lenders would be less motivated to financially back these loans and smaller companies like ours would be priced out of the ESOP option. (2) Imposition of 30% threshold before ESOP tax incentive is available would make it very difficult for many companies to even consider an ESOP. Based on the value of the company stock this 30% figure could become prohibitive. (3) The voting rights pass through requirement in Senator Bentsen's bill could prove to be a major clog in the day to day operation of both smaller and larger businesses and, (4) Although our ESOP pays no dividends the repeal of the ESOP percentage threshold

on dividend deductions could cause problems for other companies considering ESOPs.

I ask that my concerns be reviewed and hope the ESOP will remain an employee benefit and allow our employees to continue to share in the ownership of our company.

Sincerely,

TED APRILL, *President.*

ALLOY RODS CORPORATION,
Hanover, PA, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee SD-215,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and oversight of the Internal Revenue Service will hold on July 19, 1989.

Alloy Rods Corporation is a manufacturer of welding wires and electrodes. In 1988, at considerable risk to all involved employees, the employees purchased the company from its former owners. In excess of 70% of the company is now owned by its ESOP.

I believe I write on behalf of all of us at Alloy Rods that we are stunned at the swiftness with which certain key provisions of existing ESOP regulations regarding tax questions, the use of dividends, the voting of unallocated shares, are being considered by the Senate and earlier by the House as subject for change or removal.

We have the feeling that the recent publicity surrounding the use of ESOP's by some giant corporations has caused over reaction in the Senate and the House about ESOP's in general.

Our ESOP plan is now the key element of the retirement hopes of Alloy Rods employees. We are counting on all of the features of the existing law to provide the dynamics that will allow us to administer the plan over time for the maximum benefit of our employees. We believe it is short sighted to destroy the flexibility that so many of us counted on and feel that not enough investigation has been undertaken in smaller companies to see what these changes really mean.

Surely there must be some way to curtail the abuse by giant corporations while leaving all existing features of ESOP plans available to smaller companies. We know that the four items being considered i.e. (1) repeal of ESOP lender partial interest exclusion; (2) imposition of 30% threshold before this ESOP tax incentive is available; (3) the voting rights pass-through requirement in Senator Bentsen's bill; and (4) repeal or imposition of ESOP percentage threshold on the ESOP dividend deduction; would have a destructive effect at our company on our hopes for the future.

We at Alloy Rods feel we are being punished because of the actions of some of the major corporations and ask respectfully that our comments opposing these changes be considered.

Your accepting our comments are appreciated.

Sincerely yours,

ROBERT B. EGAN, *Chairman.*

AMERICOLD CORPORATION,
Portland, OR, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee SD-205,
U.S. Senate,
Washington, DC

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171 and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcom-

mittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Americold Corporation employs approximately 1,500 people in 15 states around the nation. The Company provides public refrigerated warehouse storage and services and is headquartered in Portland, Oregon. In December 1986, the Company was purchased in a leveraged buyout transaction from Beatrice Companies, Inc. A non-leveraged ESOP was established soon thereafter that offers potential retirement benefits to approximately 1,000 participating employees. Contributions to the ESOP, which were approximately 5% of the participants' earnings in each of the first two years, are discretionary depending on Company financial performance. While our ESOP is relatively new, Americold has already experienced many of the benefits often touted about ESOPS: increased employee productivity; an "ownership" mentality at all levels of employment; and a financial sharing of the success of the Company among all ESOP participants. Furthermore, we have already experienced several situations where retiring employees have terminated the Company with significant additional cash retirement proceeds due to the ESOP. Overall, the program has been a win/win situation for both the employees and the Company.

The proposed 1989 tax bill threatens to jeopardize this win/win situation. While as a non-leveraged ESOP we stand to be less severely impacted as compared to leveraged ESOP's, nonetheless our retirement benefits could still be adversely affected. Specifically, repealing or imposing a percentage ownership threshold on the dividend deduction would, at a minimum, reduce the ESOP contribution level. Imposing a percentage ownership threshold for any purpose threatens smaller plans like Americold's because the ownership builds slowly over many years of contributions. Thus, in the early years of these plans many of the benefits would not apply.

Finally, while Americold is unaffected by any change to the lender partial interest exclusion, we support retaining the 50% exclusion for leveraged ESOP's as we feel the promotion of ESOP's overall, is a worthwhile goal to help further American productivity and to encourage employee participation and ownership in American companies. The lender exclusion is a significant financial incentive in furthering this promotion.

Your accepting our comments are appreciated.

Sincerely yours,

LON V. LENEVE, *Treasurer.*

ASSOCIATED SUPPLIERS, INC.,
Portland OR, July 18, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and oversight of the Internal Revenue Service will hold on July 19, 1989.

Our company, Associated Suppliers, Inc., established an Employee Stock Ownership Trust in 1982. At the present time, our ESOT either owns outright or is under contract to purchase over seventy percent of the outstanding shares of our company. The balance of the outstanding shares are owned by individual employees who have entered a buy-sell agreement with the ES0T to be effective upon the individuals' retirement. We and our ninety-nine employee/shareholders are committed to Employee Stock ownership. It has helped us grow from a one-location company in 1982 to our present four locations and helps us to compete with large national chains.

We are strongly opposed to the repeal of the ESOP lender partial interest exclusion as this feature has been instrumental in our growth. As more than seventy percent of our outstanding shares are in our ESOT, we are not directly affected by the proposed thirty percent threshold. We do believe that present regulations on voting rights pass through are more than adequate and are strongly opposed to any change.

Your accepting our comments are appreciated.

Sincerely,

ROBERT L. SAUNDERS.

ASTRO MFG. CO., INC.,
Shippenville, PA, July 18, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989

Astro Mfg. Co., Inc., formed an ESOP plan in December of 1985 and called the plan The Employee Stock Ownership Plan. This Plan proximates 50% of the stock of the Company and is being distributed to the employees without any wage deductions or disbursement of pension plans that the employee might own. Shippenville is in a high unemployment area, but since adoption of the Plan, our employment has grown from approximately 70 employees in the bargaining unit to a current unit of 170.

I am against the following legislation: (1) repeal of ESOP lender partial interest exclusion; (2) imposition of 30% threshold before this ESOP tax incentive is available; (3 the voting rights pass-through requirement in Senator Bentsen's bill; and (4) repeal or imposition of ESOP percentage threshold on the ESOP dividend deduction.

Your accepting our comments are appreciated.

Sincerely yours,

RAYMOND A. PELTCS, *ESOP Company Executive.*

BANK OF NEOSHO,
Neosho, MI, July 18, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee SD-215,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release Number H-44, issued July 14, 1989, this is written to comment for the hearings on S. 1303, S. 1171, and other Employee Stock Ownership Plan matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Neosho Bancshares, Inc. adopted an Employee Stock Ownership Plan in January of 1986 based upon both the tax advantages available to the employer as well as the significant incentives afforded to our employees in the maintenance of the Bank of Neosho as an independent bank. Our sixty-one (61) employees are acutely aware of the significant stake owned in our business by the ESOP of approximately $950,000 or 25, and the substantial retirement benefits they will achieve as a result of the same. It is our goal to maintain the Bank as independent and responsive to the needs of the community it serves, while providing our employees with a work environment consistent with the benefits afforded by the ESOP.

The current proposed legislation, while likely aimed at so called "Wall Street" abusers of Employee Stock Ownership Plans could as well adversely affect the many ESOPs in the country such as ours, which are in place to achieve the goals of employee ownership and benefit. Accordingly, we ask the Senate Finance Committee to review with care the potential adverse effect which such pending legislation could cause for small company Employee Stock Ownership Plans such as ours.

Your accepting our comments is appreciated.

Sincerely yours,

RAY STIPP, *Trustee, Bancshares, Inc.*

BCM ENGINEERS INC.,
Plymouth Meeting, PA, July 17, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

I am President of BCM Engineers Inc., an ESOP Company since 1977, with over 800 employee owners. In fact 100% of the stock is owned by the employees. We have been able to triple in size in the last four years due primarily to the ESOP tax incentives. We were able to finance our growth through ESOP loans whereby our lender received a 50% interest exclusion and shared the savings with us. Now all our employees are benefiting and benefiting handsomely.

I strongly urge the various subcommittees to defeat any proposals to repeal the ESOP lender partial interest exclusion or to repeal or impose a percentage threshold on the ESOP dividend deduction. Such actions would have made the dynamic growth of BCM and our contribution to the American economy impossible.

Your accepting BCM's comments are appreciated.

Very truly yours,

JAMES J. JABLONSKI, *President.*

BELDOCH INDUSTRIES CORPORATION,
New York, NY, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and debt Management and the subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

We have been an ESOP company for approximately three years, with over *300 participants,* and have very strong convictions that an Employee Stock Ownership Plan has enormous benefits to the workers of America who acquire stock and equity with no cost or investment on their part. Our employees own 41% of the Common Voting Stock of our company. We have an ESOP Advisory Committee which is participating with management in the running of our company and I have found that the ESOP is a tremendous incentive to our employees.

In reading the press reports on the activities and views of the House Ways and Means Committee and Senate Finance Committee, it appears to us that our elected officials do not properly understand the enormous benefits to the participants in ESOP plans.

To incentivize owners, who create these wonderful ESOPs and their employees, we believe that a tax incentive in the form of interest exclusion is a necessity. There must be an incentive to the owners of corporations to do this wonderful deed for their employees. Under the circumstances we believe that scaling back ESOP tax incentives such as the interest exclusion deduction, ESOP dividend and the tax free roll over are a serious mistake on the part of our elected officials.

Your accepting our comments are appreciated.

Sincerely yours,

J. GENE HOCHFELDER, *Chairman.*

GEO. W. BOLLMAN & CO., INC.,
Adamstown, PA, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: In reference to Committee Press Release No. H-44, issued July 14, 1989, this is written comment for the hearings on S. 1303, S. 1171, and the other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the International Revenue Service will hold on July 19, 1989.

Our company, Geo. W. Bollman & Co., Inc., a headwear manufacturer located in Adamstown, Pennsylvania, established our ESOP on November 1, 1985. The ESOP was not established to coordinate an immediate leverage buy out, but instead, to provide a better retirement plan for our employees and to provide continuity of ownership by employees for the future. Our ESOP did not immediately own 30% of the outstanding stock, but has grown to a greater than 30% position over the years via annual contributions from the company. In a short period of time, our employees have benefited greatly by not only building a fairly sizable ESOP account, but also by sharing in the enthusiasm of ownership. Our ESOP has become the impetus for a changing corporate culture, one where management not only solicits suggestions and comments from our employee/owners, but attempts to involve our people in problem solving at all levels of the organization.

Imposing a 30% threshold and removing any ESOP tax incentives, whether they be lender interest exclusion, pass through of voting rights, or deduction of dividends, would have discouraged our company and many firms like ours from establishing an ESOP. Many smaller firms cannot or choose not to immediately become 30% leveraged or 30% owned. In our case, a more gradual growth worked for us. I, therefore, would strongly encourage congress to maintain the existing benefits for ESOP's relating to dividend deduction and interest exclusion regardless of the size of the plan. ESOP's continue to provide an opportunity for America's industries to be revitalized and to be returned to competitiveness where we have lost so much.

Thank you for accepting our comments.

Sincerely,

DON RONGIONE, *Vice President.*

BURNS & MCDONNELL ENGINEERING COMPANY, INC.,
Kansas City, MO, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

This letter is written in behalf of the employees-owners of Burns & McDonnell Engineering Company, Inc. of Kansas City, Missouri, a firm of 857 architects, engineers and technically trained people who provide professional services in the design of major power plants, airports, water, wastewater and industrial facilities.

We were able to repurchase our company some three and one-half years ago from a major manufacturing company who owned us for 15 years. We are now 100% owned by our employees, with 17% by our officer group, and 83% by our whole employee group. We are growing and prospering in the manner envisioned by the cur-

rent ESOP legislation and its sponsors and believe we are making are making a material contribution to the wealth and prosperity, not only of our employees but of the United States at large. Without the ESOP law advantages we could not have obtained the financing to purchase our company. We would have been sold to a large German manufacturing company and in all probability many of our best people would have left leading to the demise of a fine 91-year-old company.

We are very much concerned with any changes in the current legislation which we believe would hamper our ability to grow and expand our company. We are also concerned for employees in other companies in situations similar to ours who might loose the chance to recover their freedom and ability to contribute in a new and productive way to the health, wealth, and welfare of themselves and our country.

As a closely held company in the professional services business we feel very strongly about two points being addressed by Senator Bensens' bill S. 1303.

First, we believe an employee-owned company, should have at least a 30% ownership by the employee group as a whole, and preferably a majority holding. Thus, we support the requirement of at least 30% of the corporate sponsor stock being in the ESOP in order to qualify for the 50% interest exclusion on ESOP loans.

Second, we oppose full voting rights being passed through to all employees on all issues. We bring to the committee's attention that our employees now have voting rights on the four most critical issues that threaten the success of an ESOP company. These are the sale of the company, sale of a major part of the assets of the company, merger with another large company, or acquisition of another substantial company. However, complete voting pass-through in a company like ours would subject it to upheavals when unpopular actions have to be taken by the management to preserve the long-term viability of the company. In other words, you can't always run a company of our type on a "popularity contest" basis. Since all of our employees, including the management, have a vested interest in its success, we believe that responsible management will discipline itself to do only those things which are best for the entire employee group.

We also *very much oppose the loss of a tax deduction for ESOP dividends* as we believe our company really runs as a corporate form of employee partnership. Our competitors, most of whom are partnerships, are able to make distributions to their partners untaxed. We will be placed at a competitive disadvantage by being taxed twice on our distributions to our employee-owners.

Thank you for the opportunity of presenting our views to your committee. We hope your actions will be sensitive to preserving the ability of other employee groups to become "owners" of their own businesses as we have. We strongly believe employee ownership has increased the productivity of our company from 10–15% and the prosperity of our employees, and the taxes they pay to all governmental units, by a like amount.

Sincerely yours,

NEWTON A. CAMPBELL, *Chairman of the Board.*

CLUTCH & U-JOINT BROOKLYN PARK, INC.,
Brooklyn Park, MN, July 18, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Clutch & U-Joint Brooklyn Park, Inc. is an ESOP company involved in the remanufacturing and distribution of auto parts. Our 37 employees are very proud of our stake in our company and the benefits of the participation we have.

We believe that ESOP legislation of years past was designed to keep companies like ours from failure. The success we have realized will be severely curtailed if passage of Senator Bentsen's proposed legislation succeeds.

The portions of the proposed legislation which we view as negative towards ESOP's are (1) Repeal of lender interest exclusion and; (2) Repeal or imposition of

percentage threshold on the ESOP dividend deduction. Clutch & U-Joint's ESOP is indebted to a local lender and if passage occurs our growth will be jeopardized.

Your accepting these comments is appreciated.

Sincerely yours,

KENNETH J. SLIPKA, *President.*

COBRO CORPORATION,
Earth, City, MO, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

COBRO Corporation is an ESOP company. We have 500 employees who have an equity stake. At present, our employees own 40% of our common stock through a non-leveraged ESOP.

It is our opinion that the current ESOP laws serve the country and ESOP employees well. We are opposed to changes proposed by Senate bills 1303 and 1171.

Your accepting our comments is appreciated.

Sincerely yours,

JAMES J. DURNEY, *President.*

DENTSPLY INTERNATIONAL INC.,
York, PA, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate
Washington, DC

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Dentsply International Inc. is an ESOP company with approximately 700 employees in Pennsylvania and 1700 in the United States. Our Company established a leveraged ESOP in 1982. Very substantial Company contributions and steady growth in the share value of our Company's stock since the beginning of 1982 has provided our employees with ESOP account balances equal to approximately four and one-half times their current annual salary. While this is a significant benefit to our employees, of even greater importance is that the large block of shares held by the ESOP and the benefits derived from ESOP tax incentives have been important factors in enabling the Company to remain effective in a highly competitive world market and to manage for long-term growth and prosperity.

Section 133 of the Internal Revenue Code of 1986, giving financial institutions a 50% exclusion on interest income received from an ESOP when it has borrowed money to purchase stock from an employer is one of the best pieces of legislation that Congress has enacted. It helps to build capital ownership and capital earning power among America's working people. If it is repealed the only losers will be (a) the lower and middle class workers and their families who are deprived of this all too rare opportunity to buy capital ownership and (b) the economy itself. If the Committee believes that for fiscal purposes an ESOP ownership percentage threshold should be imposed before this ESOP tax incentive is available then 30% is, in our view, the appropriate percentage and one for which there is a precedent. We do not, however, believe that a requirement should be imposed to pass all voting rights through to the participants as presently required in Senator Bentsen's bill but

rather that to qualify for this tax incentive the voting rights on major issues should be passed through to the ESOP participants which, in fact, is already the law.

We also believe that the repeal of or the imposition of an ESOP ownership percentage threshold on the ESOP dividend deduction would take away an important incentive particularly from public companies to promote capital ownership among their employees and thereby unite capital and labor to produce stronger more efficient businesses and restore world-class competitiveness to American business.

We appreciate this opportunity to send our comments to the Committee through your offices.

Sincerely yours,

JOHN R. BEHRMANN, *Senior Vice President.*

July 18, 1989

Ms. Laura Wilcox
Hearing Administrator
Senate Finance Committee
SD-215
United States Senate
Washington, DC

Dear Ms. Wilcox:

Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

I am writing to you as the President of Diskriter Inc., a Pittsburgh-based employee-owned company. Our company is 97% owned by approximately 130 Associates. We were able to successfully purchase the Company from the three original owners as a result of our Employee Stock Ownership Plan (ESOP).

We are definitely opposed to sections of Senate Bills S. 1303 and S. 1171.

Please take the opportunity to carefully review the enclosed ESOP case study that was presented to a number of businessmen in the Pittsburgh area as a result of a seminar conducted by Pittsburgh National Bank. Diskriter was one of the featured companies along with Weirton Steel and Baker Engineers.

I would like to call your attention to the page entitled Diskriter Stock Value Appreciation. You can readily determine that the Diskriter stock value has increased annually about 22.4%. We definitely attribute our outstanding performance to our employee ownership and employee participation.

This case study also illustrates that Diskriter had distributed approximately $905,720 in benefits through the end of 1986. I would like to provide you with an additional update. In 1988, our ESOP distributed an additional $200,000 to two retiring service technicians. Each one of these retirees received approximately $100,000. At present, our ESOP is in the process of paying off approximately $900,000 to terminated Associates. We are able to do this because of a security acquisition loan that was recently approved by Pittsburgh National Bank. Our small ESOP will have distributed approximately $2 million to retired and terminated Associates by the end of this year.

I would also like to point out that Diskriter passed through approximately $200,000 worth of dividends to Diskriter Associates at the end of 1987.

Employee Ownership is definitely working at Diskriter. We have been able to successfully expand the ownership from three individuals to approximately 130 employee owners. We would not have been able to accomplish this without favorable legislation and favorable tax incentives.

We are opposed to the repeal of ESOP lender partial interest exclusion and opposed to the repeal of the ESOP dividend deduction.

Enclosed are ten copies of this letter. Five are for Mr. Ed Mihalski.

Your accepting comments are appreciated.

Sincerely yours,

DISKRITER INC.

Willard S. Hull
President

DISKRITER INC.

OWNERSHIP/RETIREMENT ALTERNATIVES IN 1973

GO PUBLIC

- THE MARKET WAS BAD
- FEES WERE HIGH
- LIMITED INVESTMENT APPEAL

MERGE

- TAKE RESTRICTED STOCK IN SOME CONGLOMERATE
- STOCK SALE WOULD BE RESTRICTED
- FUTURE STOCK PRICE WOULD BE AT THE MERCY OF THE MARKET
- LOYAL EMPLOYEES WOULD BE AT THE MERCY OF THE NEW EMPLOYER

LIQUIDATE

- PROBABLY THE MOST PROFITABLE
- PUT 28 LOYAL EMPLOYEES ON THE STREET
- FAMILY CONSIDERATIONS
- DESIRE TO SEE BUSINESS SURVIVE AND DO WELL

SELL TO KEY EMPLOYEES

- LIMITED FINANCIAL RESOURCES
- WOULD HAVE TO TAKE BACK PAPER
- PAY BACK WOULD COME FROM AFTER PERSONAL TAX INCOMES

SELL TO NEW CORPORATION FORMED BY EMPLOYEES

- STOCK WOULD BE PURCHASED OUT OF NET INCOME AFTER STATE AND FEDERAL TAXES -- A 45¢ DOLLAR

ESTABLISH AN EMPLOYEE STOCK OWNERSHIP PLAN (ESOP)

- A VEHICLE FOR THE TRANSFER OF OWNERSHIP OF DISKRITER INC. TO THE EMPLOYEES AT NO COST TO THE EMPLOYEES
- DISKRITER INC. WOULD MAKE ELECTIVE TAX DEDUCTIBLE CONTRIBUTIONS TO ESOP
- ESOP WOULD PURCHASE DISKRITER INC. STOCK WITH TAX DEDUCTIBLE DOLLARS -- REPLENISHING DISKRITER'S CASH RESERVES
- PROVIDES A MARKET FOR DISKRITER INC. STOCK

DISKRITER INC.

ESOP IMPLEMENTATION STEPS

- JERRY EICHELSBACHER CONSULTED WITH JOE MULACH FROM MULACH STEEL CORPORATION ABOUT MULACH STEEL ESOP

- THE LAW FIRM OF HOUSTON HARBAUGH PREPARED PLAN DOCUMENT

- THE PLAN DOCUMENT WAS ADOPTED BY DISKRITER BOARD OF DIRECTORS ON NOVEMBER 26, 1974, RETROACTIVE TO DECEMBER 1, 1973.

- THE PLAN DOCUMENT WAS SUBMITTED TO THE INTERNAL REVENUE SERVICE FOR APPROVAL

- THE INTERNAL REVENUE SERVICE APPROVED THE PLAN AND ISSUED A QUALIFICATION LETTER

- THE DISKRITER PLAN HAS BEEN AMENDED ON NINE OCCASIONS

DISKRITER INC.

ESOP MAJOR HISTORICAL CONSIDERATIONS

AUGUST 17, 1973	DISKRITER INC. AGREES TO PURCHASE STOCK FROM LEN HILL (50% ORIGINAL STOCKHOLDER)
NOVEMBER 26, 1974	DISKRITER ESOP EXECUTION DATE
DECEMBER 1, 1973	DISKRITER ESOP EFFECTIVE DATE
1974 - 1976	ESOP PURCHASES LEN HILL STOCK FROM DISKRITER INC.
MARCH 31, 1977	DISKRITER INC. AGREES TO PURCHASE STOCK FROM HAROLD SKODAL (10% ORIGINAL STOCKHOLDER)
1978 - 1980	ESOP PURCHASES HAROLD SKODAL STOCK FROM DISKRITER INC.
NOVEMBER 30, 1984	DISKRITER INC. CONTRIBUTES $362,953 TO ESOP
MAY 15, 1985	ESOP PURCHASES JERRY EICHELSBACHER (40% ORIGINAL STOCKHOLDER) TOTAL STOCK FOR $1,642,848 (32,700 SHARES) ESOP BORROWS $1,000,000 FROM PITTSBURGH NATIONAL BANK
1986 - 1991	ESOP REPAYS $1,000,000 TO PITTSBURGH NATIONAL BANK
NOVEMBER 30, 1987	DISKRITER INC. CONTRIBUTES APPROXIMATELY $700,000 TO ESOP
NOVEMBER 30, 1987	DISKRITER INC. PASSES THROUGH APPROXIMATELY $200,000 IN CASH DIVIDENDS TO DISKRITER ASSOCIATES

DISKRITER INC.

EMPLOYEE STOCK OWNERSHIP PLAN

FINANCIAL HIGHLIGHTS

YEAR ENDING	DISKRITER CONTRIBUTION $	DISKRITER CONTRIBUTION %	DISKRITER STOCK VALUE	ESOP NET WORTH	BENEFITS DISTRIBUTIONS	NUMBER OF PARTICIPANTS
1974	87441	15.0	46.99	87548	--	28
1975	50000	9.7	67.55	175811	--	29
1976	50000	9.6	78.14	246689	--	28
1977	94359	15.0	10.49*	334707	8326	41
1978	129130	15.0	12.30	486584	7661	42
1979	144861	15.0	14.60	662579	14628	45
1980	187373	15.0	16.00	841338	2462	49
1981	195891	15.0	18.30	1171004	92219	52
1982	233853	15.0	19.50	1432653	13117	53
1983	325460	14.6	24.35	1945320	21082	74
1984	362953	15.0	26.80	2489312	126913	83
1985	100000	4.7	45.00**	2620325	613412	85
1986	191047	6.7	53.00	3373671	5900	117
TOTALS	2152368				905720	
AVERAGE	165567	12.7			69671	
1987(P)	700000	25.0			--	

* DISKRITER INC. AND DISKRITER OF OHIO MERGED TO FORM ONE CORPORATION. NEW CORPORATION STOCK APPRAISED AT $10.49 A SHARE. OLD STOCK TO NEW STOCK CONVERSION FACTOR WAS 1:7.16.

** DISKRITER ESOP BECAME MAJORITY STOCK HOLDER IN DISKRITER INC. ESOP STOCK REVALUED AT MAJORITY STOCK VALUE RATHER THAN MINORITY STOCK VALUE.

DISKRITER INC

DISKRITER HIGHLIGHTS

DISKRITER HIGHLIGHTS	1973	1986 OR 1987	INCREASE (DECREASE)	PERCENT INCREASE (DECREASE)
STOCK OWNERS	3	117	114	3800%
EMPLOYEE STOCK OWNERSHIP PERCENTAGE	0	95%	95%	
TOTAL EMPLOYEES	28	150	122	436%
DISKRITER NET REVENUES	$1.4M	$11.0M	$9.6M	686%
DISKRITER PROFITS (BEFORE ESOP)	$.1M	$1.7M	$1.6M	1600%
DISKRITER STOCK VALUE (1977 VERSUS 1986)	$10.49	$53.00	$42.51	405%
ESOP NET WORTH	$0	$3.4M	$3.4M	

DISKRITER INC.

DISKRITER STOCK VALUE APPRECIATION

YEAR ENDING	DISKRITER STOCK VALUE	ANNUAL STOCK VALUE INCREASE	ANNUAL PERCENTAGE INCREASE
1974	46.99		
1975	67.55	20.56	43.8%
1976	78.14	10.59	15.7%
1977	10.49*		
1978	12.30	1.81	17.3%
1979	14.60	2.30	18.7%
1980	16.00	1.40	9.6%
1981	18.30	2.30	14.4%
1982	19.50	1.20	6.6%
1983	24.35	4.85	24.9%
1984	26.80	2.45	10.1%
1985	45.00**	18.20	67.9%
1986	53.00	8.00	17.8%
1977 VS 1986		42.51	405.2%
AVERAGE (1975 - 1986)		6.70	22.4%

* DISKRITER INC. AND DISKRITER OF OHIO MERGED TO FORM ONE CORPORATION. NEW CORPORATION STOCK APPRAISED AT $10.49 A SHARE. OLD STOCK TO NEW STOCK CONVERSION FACTOR WAS 1:7.16.

** DISKRITER ESOP BECAME MAJORITY STOCK HOLDER IN DISKRITER INC. ESOP STOCK REVALUED AT MAJORITY STOCK VALUE RATHER THAN MINORITY STOCK VALUE.

DISKRITER INC.

EMPLOYEE STOCK OWNERSHIP PLAN

EXAMPLE: 1983 100% VESTED

ESOP PLAN CATEGORY	REPRESENTATION AS A % OF 1983 GROSS INCOME
DISKRITER CONTRIBUTION	14.9%
STOCK APPRECIATION 19.50 TO 24.35 = 4.85 OR 24.9%	17.2%
FORFEITURES	1.2%
DIVIDENDS	1.0%
INTEREST INCOME	3.0%
ADJUSTMENTS FOR DISTRIBUTION	.2%
LIFE INSURANCE NET VALUE	2.1%
	39.6%

DISKRITER INC.

EMPLOYEE STOCK OWNERSHIP PLAN

EXAMPLE: 1983 100% VESTED

ACCOUNT BALANCE 1983	$40,326
ACCOUNT BALANCE 1982	$29,789
ESOP VALUE INCREASE (1983 VS 1982)	$10,537
GROSS INCOME 1983	$26,600

1983 ESOP VALUE INCREASE	÷	1983 GROSS INCOME	=	% 1983 INCOME
$10,537	÷	$26,600	=	39.6%

DISKRITER INC.

EMPLOYEE STOCK OWNERSHIP PLAN

EXAMPLE: 1987 PROJECTED 100% VESTED

ESOP PLAN CATEGORY	REPRESENTATION AS A % OF 1987 GROSS INCOME
DISKRITER CONTRIBUTION	25.0%
STOCK APPRECIATION PROJECTION 53.00 TO 62.43 = 9.43 OR 17.8%	28.8%
FORFEITURES	NOT APPLICABLE AT PRESENT
DIVIDENDS	DIRECT PASS THROUGH
INTEREST INCOME	0
ADJUSTMENTS FOR DISTRIBUTION	
LIFE INSURANCE NET VALUE	
	53.8%

DISKRITER INC.

EMPLOYEE STOCK OWNERSHIP PLAN

EXAMPLE: 1987 PROJECTED 100% VESTED

ACCOUNT BALANCE 1987 PROJECTED	$109,870
ACCOUNT BALANCE 1986	$ 82,445
ESOP VALUE INCREASE (1987 VS 1986)	$ 27,425
GROSS INCOME 1987	$ 51,000

1987 ESOP VALUE INCREASE	÷	1987 GROSS INCOME	=	% OF 1987 INCOME
$27,425	÷	$51,000	=	53.8%

DISKRITER INC.

EMPLOYEE STOCK OWNERSHIP PLAN

EXAMPLE: 1986/1987 VERSUS HISTORICAL 100% VESTED

ACCOUNT BALANCE 1985		$ 67,908
1986 CONSIDERATIONS:		
DISKRITER INC. CONTRIBUTION (6.7%)	$ 2,597	
STOCK APPRECIATION (17.8%)	12,088	
MISCELLANEOUS	(148)	
	$14,537	
ACCOUNT BALANCE 1986		$ 82,445
1987 CONSIDERATIONS:		
DISKRITER INC. CONTRIBUTION (25%)	$12,750	
STOCK APPRECIATION PROJECTION (17.8%)	14,675	
MISCELLANEOUS		
	$27,425	
ACCOUNT BALANCE 1987 PROJECTION		$109,870
ESOP VALUE INCREASE (1987 PROJECTION VERSUS 1985)		$ 41,962
ESOP VALUE INCREASE PERCENT (1987 PROJECTION VERSUS 1985)		61.8%
ESOP VALUE INCREASE (1987 PROJECTION VERSUS 1986)		$ 27,425
GROSS INCOME 1987		$51,000

1987 ESOP VALUE INCREASE ÷ 1987 GROSS INCOME = % 1987 INCOME

$27,425 ÷ $51,000 = 53.8%

DISKRITER INC.

ESOP ADVANTAGES FOR THE COMPANY

DISKRITER ASSOCIATES PERCEIVE OUR BUSINESS THROUGH THE EYES OF AN EMPLOYER RATHER THAN THROUGH THE EYES OF AN EMPLOYEE

A VERY PROACTIVE DISKRITER ADVISORY COUNCIL (NON MANAGEMENT)

A VERY PROACTIVE DISKRITER MANAGEMENT TEAM

A PURPOSEFUL CUSTOMER ORIENTATION - CARE REPORTS

A FORCED INVESTMENT RETIREMENT PLAN - TOTALLY NON CONTRIBUTORY 1987 CONTRIBUTION WILL BE 25% OF ELIGIBLE PAYROLL

EXCELLENT FRINGE BENEFITS

SUPPLEMENTAL INCOME - DIVIDENDS PASSED THROUGH IN CASH AND THESE DIVIDENDS RECEIVE PRETAX TREATMENT FOR DISKRITER INC.

LOW TURNOVER - DISKRITER TURNOVER IN 1987 IS APPROXIMATELY 16% VERSUS INDUSTRY STANDARD OF 75%

E.C. BARTON & COMPANY,
Jonesboro, AR, July 18, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: According to your Committee Press Release No. H-44 of July 14, 1989, this is a written statement for the hearings on Senate Bill 1303 and Senate Bill 1171 and on other ESOP matters that are appearing before the Congress with respect to the 1989 tax bill. We understanding this hearing is to be held July 19, 1989 with the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service.

My company is E.C. Barton & Company of Jonesboro, Arkansas. We are in the retail building material business and are a small company with lumber yards in Eastern Arkansas and in the Bootheel of Missouri. We have been an ESOP company for about fourteen years. Our company is composed of about 375 people of which approximately 250 are vested participants in the ESOP. Our ESOP is worth approximately eight million dollars and we have approximately 100 former employees who are either retired or drawing ESOP benefits for various reasons. It is interesting to note that in our twenty seven stores located in the above locations, we have lost very few managers in the past ten years since they started accumulating benefits. We have employed an outside, disinterested appraiser to value the stock since the inception of our ESOP and we have tried to run it right. Unfortunately, we were forced to get rid of our pension plan because of the 1974 ERISA Act. We simply could not live with all the requirements. Now we are afraid Congress is getting ready to make the ESOP to where small companies simply cannot afford to handle them. We are pleased with the operation and at the present time our employees own about 55% of our company through the ESOP. Hopefully that will be increased to at least two-thirds in the near future when we settle some litigation matters with outside stockholders. Not only have our employees prospered, but our company has prospered and our tax payments to the Federal and State governments have increased substantially during the period of operation of our ESOP.

We understand that the above bills will repeal the ESOP lender partial interest exclusion. We have never borrowed any money in our ESOP, but if the above mentioned legal matters are brought to a conclusion as we expect, it will be necessary for us to go into the money market in which case the repeal of the interest exclusion will kill us. While we are not affected by the 30% employee ownership feature, we know of many smaller ESOPs that would be and, in our judgment, this would be a mistake.

We oppose the voting rights pass-through and, simply stated, "too many cooks spoil the broth." In running a business you cannot have a dozen bosses and all. that voting rights thing will do is to create an impossible situation to run a sound company. The ESOP dividend deduction proposal. is almost a must if we bring our legal matters to a successful conclusion.

Frankly stated, we believe that the Senate would be well advised not to alter the above provisions. It appears that the government starts good programs such as the pension plans and ESOP, a few concerns take advantage of the situation, resulting in the Congress making changes that finally make it impossible for legitimate operators to continue. We are afraid this is what is getting ready to happen. Most companies try to do right but there are always a few rotten apples in the barrel. The Congress should realize there will never be a perfect situation in any set of circumstances; that the ESOP legislation as it presently stands is an excellent means to give the employees of small companies like ours a bright future and at the same time permit us to continue operating as the founder of this business wanted to perpetuate his company. We have tried to follow his instructions, but legislation such as is being considered today certainly makes it difficult if not impossible.

We are enclosing ten copies of this letter. Five are for Mr. Ed Mihalski and five copies are for your office. We hope you will accept our comments in the spirit in which we intend them. We have tried to run a successful business and have done so. We have tried to run a successful ESOP and, until now, have done so. Hopefully the Congress will not make it impossible to continue both of these entities. Thanks for your consideration.

Sincerely yours,

ALLEN NIXON, *Chairman.*

28-281 O - 90 - 6

EDWARDS AND KELCEY, INC.,
Levingston, NJ, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Edwards and Kelcey a consulting engineering firm of 360 people is an ESOP Company looking to become an even greater ESOP owned organization as a key ingredient of an ownership transfer plan.

We express strong opposition to the proposals to repeal key ESOP tax provisions. These provisions if enacted would cause us to reconsider increasing our employee ownership.

We respectfully request that you oppose the proposals to raise revenues by curtailing ESOPs.

Your accepting our comments are appreciated.

Sincerely,

JOHN S. URBAN, P.E., *Executive Vice President.*

Fiesta

JULY 18, 1989

MS. LAURA WILCOX
HEARING ADMINISTRATOR
SENATE FINANCE COMMITTEE
SD-215
UNITED STATES SENATE
WASHINGTON, D.C. 20510

DEAR MS. WILCOX:

PURSUANT TO COMMITTEE PRESS RELEASE NO. H-44, ISSUED JULY 14, 1989, THIS IS A WRITTEN COMMENT FOR THE HEARINGS ON S. 1303, S. 1171, AND OTHER ESOP MATTERS PENDING BEFORE CONGRESS IN RELATION TO THE 1989 TAX BILL, WHICH THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT AND THE SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS AND OVERSIGHT OF THE INTERNAL REVENUE SERVICE WILL HOLD ON JULY 19, 1989.

FIESTA MART, INC. ESTABLISHED AN ESOP IN 1979 FOR ITS EMPLOYEES. FIESTA STOCK HAS APPRECIATED FROM $21.00 TO 238.00 PER SHARE SINCE 1979. FIESTA CURRENTLY EMPLOYEES OVER 3,500 PEOPLE WHO DEPEND SOLELY FOR THEIR ESOP MONIES TO PLAN AND MANAGE THEIR RETIREMENT. THIS PLAN HAS BEEN A KEY FACTOR IN THE SUSTAINED GROWTH OF THE COMPANY AND WILL BE AN EVEN GREATER FACTOR IN THE FUTURE AS THE LONGEVITY OF OUR EMPLOYEES LENGTHENS AS WELL AS BEING ABLE TO ATTRACT NEW EMPLOYEES. TO DATE, FIESTA HAS DISTRIBUTED OVER $3,000,000.00 TO DEPARTING AND RETIRING EMPLOYEES.

THE TAX ADVANTAGES OUTLINED IN THE ORIGINAL ESOP LAW IS ESSENTIAL FOR THE FUTURE FUNDING OF ESOP'S. OUR EMPLOYEES ARE DEPENDING UPON OUR ESOP FOR THEIR RETIREMENT. ANY WEAKENING OF ESOP LAW FROM THE ORIGINAL INTENT BY CONGRESS WILL SEVERELY HAMPER OUR ABILITY TO FUND THE ACCOUNT OR EVEN CAUSE FIESTA AND ALL OTHER ESOP COMPANIES TO LOOK FOR ALTERNATIVE PLANS WHICH WOULD PROVIDE OUR EMPLOYEES LESSER RETIREMENT INCOME.

YOUR ACCEPTING OUR COMMENTS ARE APPRECIATED.

SINCERELY,

Donald L. Bonham

DONALD L. BONHAM
PRESIDENT

Fiesta Mart Inc. • P.O. Box 7481 • 5235 Katy Fwy. • Houston, Texas 77248-7481 • 713/869-5060 • FAX 713/869-6197

FRED SCHMID APPLIANCE & TV CO.,
Denver, CO, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, dated July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plan and Oversight of the Internal Revenue Service will hold on July 19, 1989.

The Fred Schmid Appliance & TV Co. is an appliance & electronics retailer, which operates nineteen stores in a three state region. We formed our ESOP in 1981 for the purpose of enabling eligible employees the opportunity to acquire an ownership interest in the Company. As of August 1, 1988, the ESOP held 98% (177,104 shares) of the Company's stock, and the fair value of the stock was determined by independent appraisal to be $47 per share.

During the current fiscal year ending July 31, 1989, we will pay $1,000,000 to past participants with a similar distribution projected for the next three to five years.

Our Company will carefully monitor with interest the Committee's actions in the above proposals and in future proposals which could curtail or weaken ESOPs and even ESOP companies. We urge you to support ESOPs and employee-ownership by voting against all proposals or versions thereof which negatively impact ESOP companies.

Your accepting comments are appreciated.

Best regards,

WILLIAM M. GOLDEN, JR., *Senior Vice President and CFO.*

GLATFELTER INSURANCE GROUP,
York, PA, July 19, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

For the record, our privately-owned company established its ESOP in January 1985 for the primary purpose of perpetuating its successful operations through its employees thereby allowing them to participate in the growth of their company through capital ownership. As a result of the ESOP incentives introduced in 1984, our ESOP has completed two leveraged purchases of employer stock resulting in the ESOP owning 40% of our company and accumulating over $20 Million of wealth for our 240 employees.

We believe that the repeal of the ESOP lender partial interest exclusion and ESOP dividend deduction, or the imposition of a 30% ownership threshold before these ESOP tax incentives are available, would have a significant negative effect on the further development of ESOPs. While these legislative proposals are a natural consequence of the mega-deals done by publicly-traded companies as a takeover defense, let's not destroy ESOP incentives for the thousands of smaller companies who establish ESOPs for their intended purpose.

We respectfully request that you consider the long-term values of promoting this country's workforce as owners of capital and not just suppliers of labor. We believe it to be imperative that current and future workers be enabled to participate in wealth accumulation through capital ownership because the efforts of their labor will never be sufficient to provide for an equitable distribution of wealth in a post industrial society.

Your consideration of our concerns is greatly appreciated.

Sincerely,

ANTHONY P. CAMPISI, *Senior Vice President/Finance.*

HARTMAN-WALSH CORPORATION,
St. Louis, MO, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear-Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Hartman Walsh Corporation is an ESOP Company with 55% of our stock owned by 93 employees. Our ESOP has been in effect since 1983.

The structuring and financing of a Company ESOP have been both time consuming and expensive to our Company, but a big benefit to our employees. We strongly oppose any repeal of the ESOP lender interest exclusion, the voting right requirement and the percentage threshold on the ESOP dividend deduction.

We are a small ESOP Company. We wish it known to the Senate Finance committee that the economic benefits to our employees would not have been possible without the present treatment given an ESOP. To take away these benefit is not in the interest of small ESOP Companies not employees.

Yours accepting our comments are appreciated.

Sincerely yours,

DONALD G. BACHMAN, *ESOP Trustee.*

HEATRON INC.,
Levenworth, KA, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989 this is a written comment for the hearings on S. 1303, S. 1171, and other E.S.O.P. matters pending before congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Heatron, Inc. established its E.S.O.P. in 1985 to buy out an existing owner and to turn that portion over to its employees. The E.S.O.P. now owns 40% of the company's stock and will purchase more if and when it becomes available. Our E.S.O.P. is the most important thing we have to offer our employees. As a small manufacturer we have found the E.S.O.P. to be of benefit to all of our employees. They honestly feel as if they have a stake in their company and are encouraged to participate on a day-to-day basis with ownership in mind.

If your goal is to govern the large E.S.O.P. Corporations we strongly urge you to keep the small companies like our own in mind. For us the E.S.O.P. represents motivation, pride and excitement. It is also unique in that we are one of only two corporations in the United States that employs prison inmates and affords them the ownership of the company where they work. This also affords them the opportunity to become more than just another inmate who is incarcerated and lost within the system.

Your actions of eliminating the interest exclusion for lending institutions will only eliminate the small companies from setting up E.S.O.P.s. Small corporations don't possess the cash to normally buy out an existing owner for the purpose of an

E.S.O.P., therefore, they must rely on a friendly lending institution who will afford them preferred rate of interest. Obviously if the lending institution isn't reaping any benefit neither will the corporation and consequently neither will its employees. The trickle down effect here is of the upmost importance.

I pray you don't consider your actions non-consequential to the majority. If E.S.O.P.s are encouraged and promoted by the government and the private sector productivity will increase, quality will increase, employment will increase and the tax revenue base will increase as a result. Please make your E.S.O.P.s your focus to help our nation and its people.

Your accepting our comments are appreciated.

Sincerely yours,

MICHAEL W. KEENAN, *E.S.O.P. Company Executive.*

HISCO,
Houston, TX, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will held on July 19, 1989.

Hisco is an ESOP company, and has had an ESOP since 1974.

The employees now own 51 percent of the Company and own the balance. We do pass through the voting rights. Many employees are fully vested.

We have 125 employees in 13 national locations. We are growing and profitable.

We feel the ESOP has been a terrific advantage to us in motivation, keeping our best people, obtaining financing and growing the company.

I do not like the abuses to ESOP's that are taking place.

I favor S. 1303 and S. 1171.

I favor any law that will prevent ESOP abuse takeover defenses, financial manipulations and any risk to the employee shareholders without their vote.

Your accepting our comments are appreciated.

Sincerely yours,

PAUL M. MERRIMAN, *President*

KATZ COMMUNICATIONS, INC.,
New York, NY, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171 and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management, and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Katz Communications, Headquartered in New York, is an employee-owned company with over 1400 employee-owners. The Katz Communications ESOP has been in existence since 1971, and has been extremely successful. Secretaries, mailroom clerks, and print shop printers, have all found our ESOP *highly* enriching (some with accounts in excess of, or close to, $100,000.00). It doesn't just benefit our executives and that's the beauty of it!

We *unilaterally oppose any legislation* that could possibly slow down or end the evolution of Corporate America towards employee-ownership. We think it should be *encouraged,* not stunted, as proposed. The distribution of capital-ownership is of

prime importance to our maintaining the middle class, and not becoming a two class society (upper and lower) and ESOP could be the key in this regard.

We appreciate your acceptance of these comments.

Sincerely yours,

BRIAN C. WATSON, *Director.*

LUMBER PRODUCTS,
Portland, OR, July 18, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

We are Lumber Products, a 52 year-old wholesale building materials company with six locations in the states Oregon, Washington and Idaho. We formed a 63% leveraged $5,000,000 ESOP in 1986. The plan covers 64 employees at year end 1988. We realize our ESOP is still in its infancy, but to date, we have attained moderate successes which we feel have come about in part by our ESOP and the participative management style the ESOP has brought to our organization. Our sales have grown in this short time from $35,000,000 in 1986 to a 1989 pace of $42,000,000. Our profitability has shown even better growth, especially when one factors in the additional interest expense we now pay along with the contribution of the ESOP which is three times the amount the company was contributing to a pension plan prior to 1987.

Our concerns about the pending legislation limiting the term of the loan along with any cutbacks in the dividend exclusion would have a serious impact on our ESOP. Our ESOP, because of a limited payroll, would not have gotten off the ground if the term of this loan was limited to 13 years as we did not have the payroll to support the debt repayment. Regarding the dividend exclusion, a small company like ours, if it shows significant profits, would be severely restricted in attempting to, repay our loan ahead of schedule without the use of the dividend exclusion. I will also add that we are currently ahead of our repayment schedule by $100,000.00.

Even though we are small in comparison with the ESOPs that have made the nationwide press, the concepts of ESOP are important to all our employee owners and we feel the current provisions need to remain in place to allow others to be able to enter into the ESOP community.

Your accepting our comments are appreciated

Cordially yours,

LARRY THOMPSON, *An Employee Owner.*

THE MAD BUTCHER, INC.,
Pine Bluff, AR, July 18, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

The Mad Butcher Corporation has been an ESOP company since 1973 and became 100% owned by the ESOP in 1983. Our 464 employee-owners reap all the benefits

since they own all of the company. Many of our hourly employees have account balances from $50 to $100,000 and have many working years ahead to accumulate much more before retiring. They will not have to be totally dependent on social security or welfare, as is the case of so many social security recipients with no other income.

As in all good things, abuse will be prevalent by a few. I have no objection to safeguards to control abuse of some ESOP incentives. They are designed to develop and help growth of capital ownership for the working people. The constant change and taking away from ESOP companies the repeal of the (1) lender partial interest exclusion, (2) imposition of 30% threshold before exclusion is available, (3) the mandating of voter pass through and (4) repeal or imposition of ESOP percentage threshold on ESOP dividend deduction is uncalled for and unfair to the ESOP companies who have counted on these incentives in either forming ESOPs or expanding their ESOPs.

Our company has not, as yet, taken advantage of any of these incentives. Since we are 100% ESOP owned we would possibly not be affected, but I still disagree with the constant erosion of ESOP tax incentives. Congress saw fit over the past few years to give tax incentives to ESOP companies because they redeemed good for all. They should not be taken away now just as a revenue enhancement. This is unfair.

Your accepting our comments are appreciated.

Sincerely,

T.E. HERVEY, JR., *President.*

MARK'S HALLMARK SHOPS,
Oregon, July 18, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1909, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

I support the requirement that the employees own 30% of the capital stock before the ESOP can qualify for:

1. Reduced interest rates due to the 50% tax credit to the lending institution on the leveraged loan.
2. Tax free dividend distribution on ESOP owned shares.

It is good and fair that the ESOP Provide for full pass-through voting-rights for employee shares acquired by the leveraged loan.

My Company is Mark's Card Shops, an Oregon Corporation, dba Marks' Hallmark Shops. We operate 26 retail card and gift stores in the states of Oregon and Washington with an annual volume of some $17,000,000 and 150 plus employees. The Company's entire stock is held by myself and Mr. David J. Lipman with the exception of a few shares that were sold to the ESOP about four years ago.

Six years ago Mr. Lipman and I decided that we would retire in 1990 and started looking for a prospective buyer. We had three interested buyers but each made it clear that upon buying the Company, each retail store would be for sale and for cash only. This would have left our faithful employees in a very insecure position as none had the finances to purchase the stores. Since formation of the Company in 1965, only three key employees have left our service and two of them died. As a result of this loyalty we felt a strong desire to protect their interests.

We discovered the ESOP plan and found it to be the answer. We had had in place for many years a Qualified Profit and Pension Plan. We formed the ESOP and transferred the assets from the Profit and Pension Plan to the ESOP. As a result by 1990 there will be adequate funds in the ESOP, with a reasonable leveraged loan from our bank to sell 100% of our stock to the ESOP and the Company will then be owned 100% by some 125 of our employees.

I feel that the 50% tax exemption afforded estates is an important benefit.

IT WAS THIS BENEFIT THAT MADE OUR FINAL DECISION TO FORM THE ESOP AND TURN THE COMPANY OVER TO THE EMPLOYEES RATHER THAN SELL FOR CASH TO OTHER BUYERS.

The 50% exclusion of the interest earned by the bank will save operating capital for the new owners. The exclusion of taxes on the dividends passed to the ESOP will further strengthen their capital position.

The ESOP is a marvelous tool to help employees acquire an equity position in our country's economy when it is formed for the right reasons.

AND THEY WORK HARD FOR IT WHEN IT IS OFFERED AND ESPECIALLY WITH THE ADVANTAGES AN ESOP AFFORDS FOR CONSERVING CAPITAL.

Your accepting our comments are appreciated.

Sincerely yours,

E.O. SINNARD, *Chairman.*

MARSHALL & STERLING INSURANCE,
Poughkeepsie, NY, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Our company formed an ESOP in 1977 which now owns 70% of all outstanding stock. Since that time our company has grown at a rate in excess of 30% annually and our stock value has increased 1,000%! The benefits to our employees have been enormous. None of this would have happened without our ESOP and we strongly oppose the constant chipping away at the incentives that make ESOP's work. We pay far more taxes today than we would have without our ESOP related growth.

The Congress should be encouraging employee ownership and not discouraging companies from giving their employees a piece of the action. By requiring pass through voting you take away management's ability to run the Company using their best judgment. By removing the lender's interest exclusion you inhibit the formation of new ESOP's and the growth of existing plans.

Please do something positive for ESOP's so that the principle of employee ownership is not destroyed.

Your accepting our comments are appreciated.

Sincerely,

JOHN P. O'SHEA, *President.*

MICHIGAN CLAIM SERVICE, INC.,
Okemas, MI, July 26, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington DC.

Dear Ms. Wilcox: Pursuant to the Committee Press Release, No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress, in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and oversight of the Internal Revenue Service, held on July 19, 1989.

Michigan Claim Service, Inc. has been an ESOP company since 1984. Since that time, our employees have felt a genuine "ownership" interest in the company and we have seen our company grow and expand, due in part to the involvement of all our employees.

As an ESOP company, we are concerned about the proposed legislation. Even though we are not a large company (270 employees), the importance of our ESOP to our company and the economic benefits to our employees is great.

It is our feeling that the Senate should not curtail the ESOP dividend deduction, code Section 404(k). In addition, we do not feel that closely held companies (such as ours) meeting the 30 threshold should provide for full voting rights passed through to employees on all stock required with a securities acquisition loan.

Your accepting our comments are appreciated.

Sincerely yours,

SCOTT T. BROOKS, *ESOP Plan Administrator.*

MID AMERICA POWER DRIVES,
Burnsville, MN, July 18, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and oversight of the Internal Revenue Service will hold on July 19, 1989.

Mid America Power-Drives is a 20 year old distributor of hydraulic systems and components. Our 56 employees most of whom are participants in our ESOP are very proud of our stake in our company and the benefits of the participation we have.

We believe that ESOP legislation of years past was designed to keep companies like ours from failure. The success we have realized will be severely curtailed if passage of Senator Bentsen's proposed legislation succeeds.

The portions of the proposed legislation which we view as negative towards ESOP's are (1) Repeal of lender interest exclusion and; (2) Repeal or imposition of percentage threshold on the ESOP dividend deduction. Mid America Power Drives' ESOP is indebted to a local lender and if passage occurs our growth will be jeopardized.

Your accepting our comments are appreciated.

Sincerely yours,

KENNETH J. SLIPKA, *Executive Vice President.*

MIDWEST GRAIN PRODUCTS, INC.,
Atchison, KA, July 18, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Midwest Grain Products, Inc. E.S.O.P. covers approximately 615 employees and has an estimated value of $25,700,000. Benefits to the employees is in their future retirement and a pride in owning company thru stock ownership.

Our company is opposed to the repeal of the partial interest exclusion, even though our ESOP is not a leveraged ESOP. We are opposed to any change in the voting rights pass-through requirements covered by Senator Bentsen's bill. We are also opposed to any change in the deduction of the ESOP dividend deduction.

Your accepting our comments are appreciated.

Sincerely yours,

ROBERT G. BOOE, *Trustee.*

OLUM'S OF BINGHAMTON, INC.,
Binghamton, NY, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Our company has been ESOP since December, 1988. Over 125 employees are now becoming owners with future financial security being made possible with this plan.

We urge you to not make any cutbacks on the ESOP dividend deductions or repeal of the lender partial interest exclusion.

Your accepting our comments are appreciated.

Sincerely yours,

OLUM'S OF BINGHAMTON, INC.

OLSON GRAPHIC PRODUCTS, INC.,
St. Paul, MN, July 20, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: In reference to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold.

Olson Graphic Products, Inc. introduced our ESOP program several years ago with the intent of making our employees feel they have an ownership stake in the Company. In our communications to employees, we frequently inform then of the benefits of our ESOP to them. As a small firm (78 eligible employees), we feel the ESOP has brought about a sense of belonging, a commitment to excellence of service to customers and efforts to contain costs and reduce waste and inefficiency. These are the qualities American workers must have in order for us to compete in a global economy.

The current repeal measures appear to be an all-out attack on ESOP incentives. The lender interest exclusion will raise the cost of borrowing which will slow the growth of ESOPs. The 30% minimum ESOP ownership is a long-term goal for an employer such as us, and realistically is not immediately achievable in order to qualify for the lender interest exclusion.

The proposed 3 year holding period for sellers to qualify for tax-free rollovers would discriminate against employees who may retire soon.

The voting rights pass through would seem to set-up conflict among employees as to how they would vote upon matters. This would tend to reduce the team spirit we are striving for. At Olson's, we invite all employees to a stockholder's meeting, inform them of the year's events and answer questions. This has worked well. No one has asked to vote on anything.

The proposed 30% threshold for the ESOP divided deduction would also reduce the effectiveness of our plan because of our previously stated reasons relating to the difficulty of achieving the 30% ownership by the ESOP.

In summary, our ESOP is attaining its goal of benefiting employees. This goal would be made more difficult to achieve if the various proposals are passed. Addi-

tionally, it would discourage creation of ESOPs because of employer uncertainty over the future direction of even more changes. We support efforts to eliminate abuses of ESOPs but believe they should be addressed in a specific manner, rather than penalize all ESOPs.

Your accepting our comments is appreciated.

Very truly yours,

GARY D. WOODFORD, *Vice President/ Treasurer.*

PANEL PROCESSING, INC.,
Alpena, MI, July 18, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Panel Processing, Inc. is a closely held company with five manufacturing facilities in four different states. We have always been interested in employee involvement and participation in our business, and we provide various benefits that promote team thinking.

Our ESOP, as it is now set up, is an important part of our company. Our owners (ESOP employees) feel more and more like owners as shares of stock continue to be distributed to them. Incentive, and concern for our future prosperity is increasing. Our people are counting on good retirement security provided by ESOP.

We are opposed to any tampering with current ESOP laws that will adversely effect the future employee ownership of our company. We are opposed to repeal of ESOP lender partial interest exclusion and imposition of 30% threshold before this tax incentive is available.

Your accepting our comments are appreciated.

Sincerely yours,

PHIL HITCHCOCK, *Executive Vice President.*

PEDERSON-SELLS EQUIPMENT CO., INC.,
Fort Dodge, IA, July 18, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Pederson-Sells Equipment Co., Inc. is a 36 year old distributor of agricultural parts. In 1986 the sole shareholder was on the verge of liquidating due to the lack of a buyer for the business. An ESOP was formed and purchased a majority of the stock giving the 7 employees hope for the future. As of this date we now have 24 employees, an additional office/warehouse location and plans for growth.

We believe that ESOP legislation of years past was designed to keep companies like ours from failure. The success we have realized will be severely curtailed if passage of Senator Bentsen's proposed legislation succeeds.

The portions of the proposed legislation which we view as negative towards ESOP's are (1) Repeal of lender interest exclusion and; (2) Repeal or imposition of percentage threshold on the ESOP dividend deduction. Pederson-Sells Equipment's

ESOP is indebted to a local lender and if passage occurs our growth will be jeopardized.

Your accepting these comments is appreciated.

Sincerely yours,

KENNETH J. SLIPKA, *President.*

PETERSON MACHINE TOOL, INC.,
Shawnee Mission, KS, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Peterson Machine Tool, Inc. has had an ESOP for fifteen years and it has had a huge impact on our employees. It is the major benefit provided and the employees are counting on its continued growth.

We are totally against (1) repeal of ESOP lender partial interest exclusion; (2) imposition of 30% threshold before this ESOP tax incentive is available; (3) the voting rights passthrough requirement in Senator Bentsen's bill; and (4) repeal or imposition of ESOP percentage threshold on the ESOP dividend deduction.

Your accepting our comments is appreciated.

Sincerely yours,

GARY N. BAKER, CPA, *ESOP Company Executive.*

PHELPS COUNTY BANK,
Rolla, MI, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other Employee Stock Ownership Plan matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Phelps County Bank, a community bank with $75,000,000 in assets located in rural Missouri, has an ESOP which owns 35% of the bank. Our ESOP was started in 1980 when the bank had assets of $20,000,000 with a first-year contribution of $14,000 and 20 eligible participants. Our first purchase of stock was for 5% of the total stock outstanding.

Our second purchase was in 1985 for an additional 8% at which time we utilized the 50% interest exclusion and were able to obtain financing at an interest rate equal to 90% of St. Louis prime. In 1988 the ESOP purchased an additional 22% of the stock from the majority owner to bring the ESOP ownership to 35%. Again, we went to a St. Louis bank and obtained financing and because of the past loan records, our rate was 85% of prime.

The interest rate exclusion, we realize, keeps current tax dollars from flowing into the Treasury BUT it allows the employees' future taxable wealth to grow significantly more since more dollars of the bank's contribution goes to pay principal payments which releases more stock directly to the participants' accounts.

Has this plan benefited our employees? The answer to that is yes, in every way. From that first contribution of $14,000 to be divided among 20 participants we have grown to an annual contribution of $260,000 in 1989 to be divided among 41 participants. The average contribution to a newly eligible participant is $3,000 per year,

and the average employee who has been in the plan since its inception had a total vested value of $20,500 as of December 31, 1988.

Has it decreased taxable income for the bank? The answer to that is no. The bank's return on assets in 1979 was 1.05%. The ROA in 1987 was 1.12%. In other words, increased productivity from employee ownership has meant that the bank has been able to increase its taxable income in relationship to asset base while at the same time contributions to the plan were being rapidly accelerated.

In 1988, we utilized the dividend deduction allowed and used the dividend paid on stock owned by the ESOP to further reduce the outstanding debt (incurred to obtain stock) which directly released additional shares to the participants.

Our ESOP is purchasing shares from a majority owner who is 70 years of age. Our goal is to be able to retire the debt we currently have (which is due to be paid by 1998) by 1992, at which time the owner has agreed to sell the ESOP enough stock to have majority control. Since our plan is a mature plan and many employees are currently fully vested, all employees are vividly aware of the importance of capital ownership and know that their production (or lack thereof) greatly impacts their own future. As an example, our production for the first half of 1989 is 125% of goal. At Phelps County Bank, EMPLOYEE OWNERSHIP IS WORKING THE WAY IT WAS INTENDED.

A reduction or elimination of interest exclusion allowed in IRS Code Section 133 or elimination of dividend deduction would seriously hamper the future growth of our ESOP and the retirement benefits accruing to our employees.

Your accepting our comments is appreciated.

Sincerely,

PHELPS COUNTY BANK EMPLOYEE STOCK OWNERSHIP COMMITTEE.

POLYTOP CORPORATION,
Rhode Island, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Having read your Committee Press Release No. H-44, issued July 14, 1989, I write this comment for the hearings on S. 1303, S. 1171, and other ESOP matters before the Congress and tied to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Polytop Corporation has recently positioned itself to offer an ESOP to its employees having studied the history and benefits which ESOP employees and employers have garnered. We are a manufacturer of dispensing closures and employ about 400 people here in Northern Rhode Island.

Polytop endorses the current law as it relates to ESOP's and is opposed to changing it in any of the ways currently being proposed particularly the following:

1. The ESOP lender partial interest exclusion repeal,
2. The establishment of a 30% ownership limit before the ESOP tax incentives are available,
3. The requiring of voting rights pass-through in order to qualify for incentives,
4. The setting of a percentage threshold or the repeal of the ESOP dividend deduction.

Thanks for listening!

Respectfully yours,

ROBERT E. HARDING, *Vice President, Finance.*

REISEN LUMBER INDUSTRIES,
Union, NJ, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Reisen Lumber Industries, Inc. is an ESOP company with over 100 employees. We established our ESOP in 1986 and purchased 100% of the stock of our company, using borrowed funds, which we have been repaying for the past three years.

There is no question that our ESOP would not have been possible had we not been able to secure bank financing at favorable rates made possible by the bank's ability to shelter 50% of the interest they receive from us from their income for Federal tax purposes. Even though Sen. Bentsen's bill allows banks to shelter half the interest income, the imposition of the 30% threshold before this incentive is available is arbitrary and difficult to administer. Further, the threshold may well prevent otherwise viable ESOP plans from being implemented.

Our employees have already established considerable equity in our company and that equity will continue to increase as we retire our ESOP debt and the company grows. The employees are truly owners and they behave as such. Our sales per employee are up and our expenses per employee are down. (And I must add that our Federal income taxes are up as well—a common result of enlightened tax policy!)

If the proposed changes become law, many ESOPs will never have a chance to get started. And we may not be able to refinance our loan, change banks, or borrow additional funds at favorable rates should any of these actions become necessary.

I'm writing on behalf of our employees to oppose any change in tax law affecting ESOPs at this time. ESOPs can and do make valuable contributions to the economy by broadening the ownership base, motivating employees and stimulating productivity improvements so badly needed by the United States in the global marketplace.

Thank you for accepting our comments.

Very truly yours,

ROBERT W. HOWARD, *President.*

SEAMAN-PATRICK PAPER COMPANY,
Detroit, MI, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittees will hold on July 19, 1989.

Our unleveraged ESOP has been in place since January 1, 1983. Since that time we have had some very good years from all points of view. The market value of the total assets in our ESOP approximated $2,953,000 as of December 31, 1988, the most recent year end of our Plan. There were 89 participants in the Plan as of December 31, 1988.

It is our belief that the dividend passthrough on employer securities held in our Plan (market value of $1,356,400) has had a very positive effect on our employee's attitude toward their work and the Company. There is a very enthusiastic atmosphere each year when we pass out the dividend checks. Our decision to pass through dividends is very much associated with the tax deduction which the Company receives. We are very much in favor of continued deductibility of dividends which are passed through to participants.

We believe it would be a mistake to repeal (or to impose an ESOP ownership percentage threshold) on the dividend deduction, and we believe it would be very unfair

to future participants in our ESOP, as well as those in all other ESOP's. Money coming from the plan today has much more of a motivating impact on employees than money that will come much later in life.

Enclosed are ten copies of this letter; five are for you; five are for Mr. Ed Mihalski, Minority Chief of Staff, Senate Finance Committee. Any consideration given to our comments will be appreciated.

Very truly yours,

G.H. ASHLEY, *Vice President, Finance.*

SPANGLER INC.,
Kansas City, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
United States Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Spangler Inc. (dba/Spangler Printers) established its ESOP in 1977 for the benefit of its employee-owners and to provide a transition vehicle for our founder to transfer ownership upon his death.

During the period 1977 to present our sales and assets have increased 400% and our employment has increased from 65 to 150. Currently the ESOP holds roughly 50% of the stock, our total corporate net worth stands at over $3,000,000. We credit our ESOP incentive for much of what we have accomplished in recent years.

On behalf of our company and our employee owners I implore your committee, our Senator and Representatives to please quit tinkering with the ESOP provisions. The constant attacks on ESOP's are destined to kill this most innovative and beneficial means of sharing capital ownership. It has gotten to the point that no one can make plans because the rules are constantly changing under us.

Spangler is well over the 30% level in its ESOP so that limitation is not a problem to us. The preservation of the interest exclusion and dividend exclusion are important but not at the expense of losing other key ESOP provisions such as §2057 or §2210 or by changing voting rights. These are key provisions for *small business* ESOP's.

If you want to curb mega-merger abuses fine, but don't do it by effectively killing one of the few good pieces of legislation written in the last decade.

Thank you for considering our perspective.

Sincerely yours,

GARY R. STAAB, *Executive Vice President.*

SUNNYDALE FARMS,
Brooklyn, NY, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Sunnydale Farms is a $100,000,000 company in the East New York section of Brooklyn. We are a 100% ESOP company which includes union and nonunion employees totaling 354. We are very much opposed to the changes being considered in the ESOP legislation namely:

1. repeal of ESOP lender partial interest exclusion;

2. imposition of 30% threshold before this ESOP tax incentive is available;
3. the voting rights pass-through requirement in Senator Bentsen's bill;
4. repeal of the ESOP dividend deduction.

We feel that changing the ESOP laws will be very detrimental to the formation of ESOP companies in the future.

We appreciate your accepting our comments.

Sincerely yours,

DAPHNE JO STASCO, *Chief Financial Officer.*

UNITED MISSOURI BANK,
Kansas, City, KS, July 18, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44, issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171, and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcommittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

The ESOP of United Missouri Bancshares, Inc. has been in existence since 1978. It currently holds approximately 6 of our Company's outstanding shares, having a present market value of more than 20 million. More than 1,800 employees participate in this Plan.

The majority of the stock acquired by our ESOP since 1982 has been purchased with the proceeds of ESOP loans. The favorable loan rates made possible by the 50% interest exclusion feature of Code section 133 has induced management to approve the acquisition of large blocks of stock whenever they have become available at an attractive price. As a consequence our employees are achieving an increasingly significant ownership position in our Company while also experiencing substantial gains in their account values as shares are released for allocation at a higher market value than their cost to the ESOP.

The composition of our Company is such that it is highly unlikely that the ESOP will ever attain a 30% ownership position.

The effect of the passage of either S. 1303 or S. 1171 on our ESOP would be that the purchase of stock would be discontinued except as available funds permit. The result would be to reduce the Plan's rate of growth and to increase the cost of the stock acquired. Both results would be disadvantageous to our employees.

Although as a publicly-held company we pass through voting rights to all ESOP participants, we do not feel that it is either necessary or wise to mandate the pass-through of voting rights of all ESOP-held stock, particularly in the case of small, publicly-held companies.

Our employees generally consider our ESOP to be the most important element of their retirement planning. We believe that any curtailment of the existing tax advantages afforded ESOPs would be particularly harmful to our employees and generally harmful to all ESOP participants.

Very truly yours,

PAUL L. SKAHAN.

VIKING ENGINEERING & DEVELOPMENT, INC.
Fridley, MN.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox: Pursuant to Committee Press Release No. H-44 issued July 14, 1989, this is a written comment for the hearings on S. 1303, S. 1171 and other ESOP matters pending before Congress in relation to the 1989 tax bill, which the Subcom-

mittee on Taxation and Debt Management and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service will hold on July 19, 1989.

Viking Engineering & Development, Inc. established a Stock Bonus Plan with ESOP features in 1981. In 1984 this plan was replaced with a full ESOP Plan to accommodate a leveraged ESOP loan and begin the purchase of our majority shareholder's stock. At the present time the ESOP owns 80% of the outstanding company stock. We have seen and increase in plan participants from 49 in 1982 to 80 in our current fiscal year. The value of our plan has grown from $40,000 in 1982 to nearly $4,000,000 at the close of our fiscal year ending in 1988. Many of our long term employee-owners have ESOP account balances in excess of $50,000. Prior to our ESOP Viking Engineering & Development, Inc. had no qualified retirement plan.

We are *against* any repeal or modification of the interest exclusion or dividend deduction provisions currently provided to ESOP companies. These two provisions are clearly a major factor in the formation of ESOPs that provide capital ownership and retirement benefits to many employees. The current and long-term benefits provided by ESOPs will far exceed the short term deficit reduction by the repeal of these provisions.

Your accepting our comments are appreciated.

Sincerely,

DEAN M. BODEM, *VP.*

TOKHEIM CORPORATION,
Fort Wayne, IN, July 19, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
Washington, DC.

Dear Ms. Wilcox: In order for the United States to compete in Europe and to create employment for our people, we must continually seek and enhance—not destroy—methods to become more productive.

Employee Stock Ownership Plans, when meaningful and significant to employees, are important tools to improve productivity. Studies indicate that companies with significant employee stock ownership expand more rapidly than other companies; however, for ESOPs to have value, they must be of a size to which employees can relate. Contributions to an ESOP of less than 1%-2% of wages are so insignificant that employees are not impacted sufficiently by a company's gains or losses. Plans which increase the number of shares going to employees, based on a company's profitability, earnings per share, return on equity, or some other measurable factor, can be very important to the growth of that company.

If you recommend proposed legislation on ESOPs, I suggest the following:

1. Legislation should not impact ESOPs where an amount equal to at least 3% of an employee's wages is put into an ESOP each year.
2. ESOPs should be limited in value to let's say $100,000,000, because ESOPs appear to be less meaningful to large companies than to medium-size and small companies.
3. Employees should have the right to vote their shares and the shares should have equal voting rights with other shareholders.

In some instances ESOP loans may have been somewhat of a facade to receive lower interest rates, because the number of shares allocated to employees over time have been insignificant and meaningless, however, in many other instances ESOPs were meant as a way to improve employee productivity and participation in the companies. To introduce legislation to reduce productivity improvement appears irresponsible.

Your support is needed to ensure continued improvement in productivity through Employee Stock Ownership Plans.

Very truly yours,

J.E. OVERMYER.

P.S. Research indicates that ESOP firms would generate 40% greater sales and 46% greater employment growth over a ten-year period.

WOLF FURNITURE ENTERPRISES, INC.,
Altoona, PA, July 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Ms. Wilcox:

RE: S. 1303, S. 1171 As Affecting E.S.O.P. Loans and Dividends

Hearings are scheduled for July 19, 1989 on the amendment to the law affecting E.S.O.P.s. Our company is 85 years old, has 220 employees and serves a large portion of Central Pennsylvania with 18 stores. Our E.S.O.P. has 220 members and has existed for six years. Our E.S.O.P. is the principle retirement benefit of our associates and any impairment of the laws affecting E.S.O.P.s could affect these benefits seriously.

We are concerned that the repeal of the E.S.O.P. law that permits a lender to partially exclude interest from his income will reduce the willingness of our local lenders to assist us in further E.S.O.P. borrowing. Although the 30% threshold before the E.S.O.P. tax incentive would become available does not directly affect us since our company is owned 38% by the employees, we do feel that this change in the law would impose a serious damper on the availability of funds for E.S.O.P. companies. We are especially concerned that any changes in the E.S.O.P. law might affect the deductibility of the dividends paid to the E.S.O.P.

We believe that the present law is important to the growth of E.S.O.P.s and the concept of employee ownership of their company is a very valid and workable concept. We, therefore, recommend that the law remain unchanged.

Thank you for your attention to these comments.

Sincerely yours,

GERALD P. WOLF, *Chairman of the Board.*

STATEMENT OF SOUTHWESTERN BELL CORPORATION

Southwestern Bell Corporation (SBC) appreciates the opportunity to express its views regarding S. 1171, S. 1303 and other pending proposals with respect to Employee Stock Ownership Plans (ESOPs) SBC believes that ESOPs are a valuable means of giving employees a direct stake in the success of their companies and, hopefully, of enhancing employee wealth. However, if Congress believes some of the tax policies which foster these objectives should be changed, care must be taken to avoid penalizing plans which were developed in reliance on current law.

Historically, since 1974, ESOPs have been favored with numerous tax incentives by Congress to encourage companies to put their stock in the hands of employees. As recently as 1984, the Deficit Reduction Act encouraged ESOPs by: (1) allowing qualified lenders to exclude from taxable income 50% of interest received on loans to ESOPs; and (2) excluding dividends paid on stock held in ESOPs from corporate taxes. Even more recently, the Tax Reform Act of 1986 while eliminating many tax deductions and exemptions, did not impair the 50% interest exclusion on ESOP loans or the deductibility of dividends used to repay ESOP loans.

ESOP tax preferences were enacted into law to incite companies to place greater ownership of capital in the hands of employees encouraging greater participation in the control and success of the company. Employee ownership, in turn, improves productivity and profits. ESOP participation can be financially more advantageous to employees due to appreciation in their stock ownership.

With this in mind, SBC began an evaluation of ESOPs in late 1988 and commenced implementing a plan in early 1989.

On March 31, 1989, the SBC Board of Directors authorized up to $500 million for the establishment of leveraged ESOPs to effectively place more company shares in the hands of its employees. Public announcements were made through an employee newsletter and a press release on that date. SBC's commitment to the establishment of these ESOPs assured the prefunding of the company match programs as part of our existing employee savings plans, effectively replacing the uncertainty of future benefits. Salaried employees were informed of an increased company matching contribution to 80% from the existing 66.7%, clearly placing more value into the employees account.

SBC arranged through its financial advisors for the issuance of $455 million of ten year ESOP notes in the private placement market. Agreement in principle between SBC and twenty-one investors was reached on May 19, 1989 when the coupon rate was established. Due diligence between SBC and its investors was conducted on June 2, 1989.

The Savings Plan text revisions were completed for Salaried and Non-Salaried employees as well as the ESOP Trust Agreement on June 21, 1989. The Note Purchase Agreement (containing specific details of the ESOP loans) were finalized with the twenty-one investors on June 28, 1989. SBC has guaranteed repayment of the debt. And proceeds of the loan became directly available to our trustee, Bankers Trust on June 28, 1989.

On June 29, 1989 Bankers Trust began purchasing SBC shares in the open market and it is estimated that approximately 8.5 million shares will be purchased over the next three to four months.

Since late 1988, SBC moved steadily and in good faith toward the timely implementation of two ESOPs under the intent and design of the last fifteen years of ESOP legislation, (i.e., to place more company shares in the hands of employees encouraging greater participation in the control and success of the company)

On June 7, 1989, as SBC was committed to establishing its ESOPs, Rep. Dan Rostenkowski introduced H.R. 2572 to repeal the partial exclusion for interest on ESOP loans, effective after June 6, 1989. On June 13, 1989 Senator Robert Dole introduced S. 1171, which would also repeal the interest exclusion on ESOP Plans. On July 1, 1989, Chairman Bentsen introduced S. 1303, to repeal the interest exclusion with grandfathering provisions similar to H.R. 2572. Both bills in the Senate are effective with ESOP loans made after June 6, 1989.

The repeal of the interest exclusion on qualified loans eliminates one of the major incentives for companies to establish ESOPs for their employees. SBC firmly believes in the preferences originally legislated to achieve this appealing social goal—placing more ownership and value in the hands of its employees. But, if the elimination of the interest exclusion on ESOP loans is necessary to raise revenues to reduce the Federal budget deficit, it is important that the transition rules accommodate companies that committed to ESOP plans in reliance on existing law. For example, SBC, through its financial investment advisors and the twenty one lenders agreed in principle on the coupon (interest rate) on May 19, 1989. Confirmations were sent to all twenty one investors on that same date which included the principal amount, interest rate and maturity of the loan. A majority of the investors signed the confirmation and returned it to SBC's agents, some did not. But all investors closed on the transaction in accordance with the amounts and terms as outlined in the original confirmation. Closing occurred on June 28, 1989.

A number of companies had similarly committed themselves to creating ESOPs before any legislation was introduced but did not close their deals until later. SBC supports the House Ways and Means Committee action making July 10, 1989, as the effective date. If the June 6, 1989, effective date is retained, grandfathering provisions should include a public announcement standard such as is employed in S. 1171 and/or use of documents such as the loan confirmation letters in SBC's example as evidence of a binding loan commitment for purposes of S. 1303.

The reconciliation bill in the House Ways and Means Committee also would repeal the dividend deduction for stock purchased by an ESOP after July lo, 1989 unless the ESOP owns at least 30 percent of the employer's stock.

Section 404(K) is an important incentive for companies to create and expand ESOPs. If the ESOP dividend deduction is repealed, dramatically fewer companies will create or expand ESOPs. Erosion of the Section 404(K) deduction will discourage the formation of ESOPs and thereby curtail the most promising means of allowing employees to make capital investments they would often otherwise be unable to afford.

The Section 404(K) deduction is an incentive for companies to share larger economic benefits with employees than is the case under other employee benefit plans. ESOP dividend payments are not subject to the Section 415 plan contribution limitations. This enables companies to provide a significant ESOP plan and also maintain other benefit plans. ERISA non-discrimination rules apply to ESOPs, ensuring that ESOP dividends are distributed fairly to all ESOP participants.

Elimination of the double taxation of dividends paid on ESOP stock encourages a full pay out of the earnings on employees' capital, and promotes a wider distribution of capital ownership.

Under the original intent of the ESOP legislation, SBC has acted in good faith by adding value to its employees through the establishment of an ESOP. And, as evidenced by the commitment of substantial resources and expense, SBC has moved

toward the timely implementation of these ESOPs. Any legislation repealing the tax benefits of current law should grandfather companies such as SBC which committed to establishing ESOPs prior to the introduction of any legislation.

Statement of the Turner Corporation

TURNER ESOP

The Turner Corporation, parent of Turner Construction Company, largest general builder in the United States with domestic offices in thirty major cities and 1988 construction in place of $3.2 billion, had long been considering an employee stock ownership plan. In late 1988, management proposed to its Board a leveraged ESOP which would purchase preferred Turner stock convertible into approximately 20% of its common. Given the intensive service nature of the company's business and the importance of Turner's employees satisfying its customers, management concluded an ESOP would truly stimulate even higher performance by its staff. Turner's ESOP was to be a net positive benefit—employees would not surrender other benefits for the ESOP benefit.

After considerable work, in February the Directors appointed an independent Board committee to analyze the ESOP in definitive detail with the assistance of outside legal counsel and other advisors. Manufacturers Trust Hanover Company was engaged for financial advice, State Street Bank and Trust was hired as trustee and Houlihan Lokey was retained as preferred stock appraiser. A bank financing proposal was even in hand. On March 9, 1989, the independent committee reviewed everything and final drafts of the ESOP, trust agreement, purchase agreement, financing term sheet, minutes, resolutions and preferred stock terms were all prepared and negotiated.

On April 13, 1989, the independent committee recommended the entire Turner ESOP program. On April 14, 1989, the full Board adopted the plan, authorized the preferred stock sale and approved the loan term sheet. On May 12, 1989, the chairman announced the ESOP's serious consideration at the Turner Annual Meeting. Then, because of delays in the initial bank's proposed loan agreement and syndication, Turner asked Wells Fargo Bank to make a proposal for financing the ESOP. On June 2, Wells Fargo submitted a term sheet and that day an agreement in-principle was reached on the loan principal amount, term and rate. Although Wells Fargo had internally authorized a financing commitment by June 6, it was not until June 7 that Wells Fargo actually executed and delivered a binding commitment letter for the financing. Turner's share purchase agreement was executed with State Street Bank on June 9. On July 7, 1989, Turner closed its ESOP Program with an $18.2 million financing with Wells Fargo Bank.

Thousands of hours of work and substantial dollars will be lost, and all Turner employees will lose, if Turner is now penalized with the loss of important ESOP tax benefits. Respectfully, Turner asks that it be permitted a "grandfather" exception to the proposed legislation. Questions can be directed to Joseph V. Vumbacco, Senior Vice President, The Turner Corporation, 633 Third Avenue, New York, NY 10017 (212-878-0473).

Statement of the International Union, United Automobile, Aerospace, and Agricultural Implement Workers of America (UAW)

This statement is submitted on behalf of the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW). The UAW represents one million active and 500,000 retired workers and their families.

The UAW appreciates the opportunity to present its views on the subject of employer-sponsored retiree health insurance plans and employee stockownership plans (ESOPs). The collective bargaining agreements negotiated by the UAW with the major automobile, aerospace and agricultural implement companies provide health insurance benefits to retired workers and their families. These include supplementary, "wrap-around" health insurance benefits to retirees who are enrolled in Medicare, as well as complete health insurance coverage to pre-65 retirees. The UAW has also negotiated ESOPs with a number of smaller companies. These ESOPs have been used to prevent plant closings and the resulting economic dislocation for workers and their communities.

RETIREE HEALTH INSURANCE PLANS

I. The Problems

The major problems which have arisen in connection with employer-sponsored retiree health insurance plans are the same problems which confront our overall health care system. These problems can he summarized as (1) difficulties in obtaining access to health care and (2) rapidly escalating health care costs.

(A) Access to Health Care

In recent years, public attention increasingly has focused on the problems which millions of Americans face in obtaining access to basic health care services. Today, approximately 37 million Americans do not have any health insurance. Fifty million persons are without health insurance coverage for at least part of the year. Millions more are covered by health plans with inadequate benefits. Because they lack adequate health insurance coverage, these Americans have difficulty obtaining access to needed medical services. Too often they are forced to postpone or do without medical care because limited family income must be used for food, housing or other basic needs.

Very often, individuals covered under employer-sponsored retiree health insurance programs lose their coverage. In all too many situations during the last two decades, employers have unilaterally terminated their retiree health insurance programs. This has often occurred in the context of plant closings and bankruptcies. The most notorious example occurred in July, 1986, when LTV Corporation filed for reorganization under Chapter 11 of the Bankruptcy Code and, at the same time, unilaterally terminated all health insurance benefits for approximately 80,000 retirees and their families. There are scores of other cases in which employers have attempted to terminate their retiree health insurance programs or reduce benefits substantially. A partial list of the cases in which UAW-represented retirees have been involved is attached to this statement.

In these cases, the impact on retired workers and their families has been devastating. This has been particularly true for those retirees and their spouses and dependents who are not yet eligible for Medicare and, hence, are left without any health insurance protection whatsoever.

In many cases, the retired workers cannot replace the health insurance coverage which is lost when the employer-sponsored program is terminated. It is usually difficult for the retirees to re-enter the workforce and obtain group coverage under another employer's health insurance program, and individual health insurance policies are generally prohibitively expensive. Indeed, individual policies may not be available at any price for older individuals with serious medical conditions who may he considered "uninsurable" by private insurance companies. Because they cannot replace the lost health insurance coverage, retired workers and their families often have difficulty obtaining access to needed medical services.

The termination of employer-sponsored retiree health insurance programs also represents a significant financial hardship on retirees. In situations where the retirees cannot replace the lost health insurance coverage, the onset of serious illnesses may saddle the retirees with huge medical bills that wipe out a lifetime of savings. Even in those cases where the retirees are fortunate enough to obtain individual health insurance policies, the high cost is still a terrible burden for persons living on fixed incomes. The net result is a sharp drop in their standard of living.

It is also important to recognize the serious psychological trauma which is suffered by retirees following the termination of employer-sponsored retiree health insurance programs. The retirees are suddenly faced with the prospect of having to live in constant fear of getting sick, not knowing whether they will be able to obtain needed medical care or how they will he able to pay for such care. They are also faced with an abrupt change in their retirement expectations. In many cases, the decision to retire is based in large part on the expectation that the employer will continue to provide and pay for health insurance coverage for the rest of the retiree's life. When this expectation is suddenly dashed, the retirees have very little recourse. They cannot undo their retirement or start a new career.

In addition to the complete termination of retiree health insurance programs, employers have increasingly begun to take steps to reduce the benefits provided under these programs. Sometimes these cutbacks are applied to current retirees; in other cases they are simply imposed on future retirees. In some cases the cutbacks take the form of increased deductibles, copes, and premium sharing by retirees. More recently, there is a growing pressure from employers to change the basic plan design from a defined benefit approach, which guarantees retirees a specific health care benefit package to a defined contribution approach, which only promises a certain

monetary contribution to the retirees. Regardless of the precise approach taken by an employer, the net result is a reduction in the protections afforded to retirees under the employer-sponsored retiree health insurance program. Retirees are left with inadequate health insurance coverage, which shifts a larger percentage of the health care costs to the retirees, and exposes them to the on-going, corrosive effects of medical inflation.

The UAW has been in the forefront of the struggle against efforts to terminate or reduce benefits under employer-sponsored retiree health insurance programs. For example, after LTV Corporation filed for bankruptcy and terminated its retiree health insurance program in July 1986, the UAW and Steelworkers worked to enact the Retiree Benefits Bankruptcy Protection Act of 1988. This important legislation prohibits companies from unilaterally terminating health insurance coverage for retirees upon filing for bankruptcy. Instead, companies must continue paying such benefits until the authorized representative of the retirees agrees to modifications, or a court determines that modifications are necessary to permit reorganization of the company, and are fair and equitable to the retirees and all other interested parties. Any plan of reorganization must provide for the continued payment of retiree insurance benefits at the level agreed to by the authorized representative of the retirees or determined by the court to be "necessary, fair, and equitable." This landmark legislation will prevent companies, like LTV, from using the bankruptcy code as a device to arbitrarily reduce or eliminate retiree health insurance coverage.

In addition, the UAW has also been actively involved in litigation challenging efforts by employers to reduce or eliminate retiree health insurance coverage. We believe that retiree health insurance is a vested, lifetime benefit, promised by employers for the duration of retirement and which may not be reduced once a worker (whether union or non-union) retires. Since the retiree has rendered all of his or her promised services to the employer, upon retirement he/she is entitled to get the benefits the employer has promised in return, and the employer may not renege on its commitment. These principles have been recognized by some courts. *See e.g., UAW* v. *Yard-Man, 716 F.2d 1476 (6th Cir. 1983, cert. denied 104 5. Ct. 1002 (1984); UAW* v. *Cadillac Malleable Iron Co., Inc.*, 728 F.2d 807 (6th Cir. 1984); *Local 150-A, UFCW* v. *Dubuque Packing*, 756 F.2d 66 (8th Cir. 1985).

The bankruptcy legislation and litigation dealing with retiree health insurance benefits cannot provide a complete solution to the problems facing retirees and their families. Unfortunately, any system that relies on employer-sponsored health insurance coverage must recognize that employers sometimes find themselves in difficult financial situations, and sometimes even fail. The bankruptcy legislation and litigation can stop unscrupulous companies from evading their obligations to retirees, but cannot protect retirees from losing health insurance benefits in situations where companies legitimately do not have the resources to pay for the benefits. Future retirees have no protection under current law for their expected benefits.

(B) Escalating Health Care Costs

For the last two decades, the medical care component of the consumer price index (MCPI) has risen much faster than overall inflation (CPI). Although the growth rate moderated somewhat during the mid-1980s, recent evidence suggests a renewal of rapid medical cost inflation.

As a result of the continuing escalation in health care costs, in 1987 the United States spent 11.2 percent of its Dross national product (GNP) on health care. This compares to only 6 percent of a much smaller GNP spent on health care in 1965. In dollar terms, this country spent nearly $500 billion on health care in 1987, or about $2,080 for every man, woman, and child in the United States. Informed forecasts suggest that, by the year 2000, the United States will he pouring over 12 percent of its GNP into the health care system, or over $2,500 in 1987 dollars per person.

The escalation of health care costs has had a dramatic impact on employer-sponsored health care programs. Recently we have seen cost increases of over 50 percent in some of our negotiated health plans, and 15 percent cost increase projections are common. The rise in health care costs has been so dramatic that many persons in the business community are finally beginning to call for fundamental changes in the health care system.

The continuing escalation in health care costs has been particularly serious with respect to retiree health insurance benefits. Medicare expenditures increased an average of 9 percent per year from 1983-1987. Health care expenditures under the retiree health insurance programs negotiated by the UAW have been increasing at a similar rate.

The continuing escalation in health care costs is making it increasingly difficult to provide health insurance coverage for retirees. The Federal Government, employ-

ers, and individuals face the same problem. There is increasing pressure on the Federal government to make cuts in Medicare. This contraction in public benefits simply shifts the costs to the private sector, and yet that shift encourages employers to reduce or totally eliminate their health programs for retirees. It also makes individual health insurance more expensive for retirees.

The rules which have recently been promulgated by the Financial Accounting Standards Board (FASB) on the reporting of retiree health liabilities have made the situation even worse for employers. Because the new FASB rules will require employers to show retiree health benefit liabilities on their financial statements, employers have become increasingly concerned about the magnitude of and the continuing escalation in these liabilities. As a result, many employers have become more aggressive in their efforts to reduce or eliminate retiree health insurance benefits.

II. The Solution

The UAW firmly believes that the ultimate solution to the dual problems of access to health care and escalating health care costs—both for retirees and for the population as a whole—is the enactment of a comprehensive national health care program. Such a program would provide universal health insurance coverage to all Americans. At the same time, it would include effective cost containment programs that would replace the current provider-driven, fee-for-service system of delivering medical care, with a system that relies on prospective payment of providers and overall budgeting of health care expenditures.

The Committee for National Health Insurance (CNHI) has developed a proposal, entitled the "Health Security Partnership," which would accomplish these goals through a federal-state partnership. The UAW strongly supports this proposal, and urges Congress to give it serious consideration as a solution to the health care problems facing this country, including those relating to employer-sponsored retiree health insurance programs.

If Congress is not prepared to take such dramatic action at this time, there are several lesser steps which can be taken which would have a positive impact on the problems associated with employer-sponsored retiree health insurance programs. First, Congress should move forward with legislation to contain escalating health care costs. In 1988, Congress enacted the DRG-based prospective payment system for reimbursing hospitals under Medicare. Although there have been some problems in the implementation of the DRG system, on the whole it has been effective in restraining increases in hospital costs under Medicare. The Finance Committee will soon be considering significant changes in the system for reimbursing physicians under Medicare, including the establishment of a relative value scale, an overall limit on expenditures for physicians, and limitations on balance-billing by doctors. The UAW strongly supports these important steps towards the goal of containing physician costs under Medicare.

However, we are concerned that any measures which help to contain the Federal government's costs under Medicare may simply have the effect of shifting increased health care costs to the private sector. Hospitals and doctors will have a tremendous incentive to increase their charges to employers and other private payors, in order to make up for any reduction in their income under Medicare. Thus, the only way to truly contain escalating health care costs, and to prevent the shifting of these costs among different payors, is to establish an "all payors" system with comprehensive cost containment programs. This could be accomplished by extending the cost containment measures under Medicare to the private sector. Or it could be accomplished through a new approach, such as the proposed "Medicare Solvency and Health Care Financing Reform Act of 1985 (S. 1346) which was introduced by Senator Kennedy in the 99th Congress. The enactment of such legislation would help to ease the cost pressures on all employer-sponsored health care programs, including retiree health insurance programs.

In addition to cost containment legislation, Congress should consider legislation to improve access to and the security of benefits provided under employer-sponsored retiree health insurance plans. Most importantly, there is an urgent need for some form of vesting and accrual standards to make sure that retiree health insurance benefits cannot be arbitrarily reduced or eliminated—either for active employees or for persons who have already retired. Retiree health insurance benefits are not simply a gift or gratuity which the employer bestows upon workers when they retire. These benefits represent a form of deferred compensation, which is earned by workers over their entire working careers. In effect, workers forego higher wages and other benefits in exchange for the promise of health insurance benefits during their retirement. Thus, it is simply unfair to allow employers to renege on their

part of the bargain, and to arbitrarily reduce or eliminate retiree health insurance benefits for individuals who have already retired, or for active workers who have performed long periods of service for the employer.

With the enactment of ERISA in 1974, Congress required employer-sponsored pension plans to meet certain minimum vesting and accrual standards. These reforms were enacted to ensure that retirees and workers with long periods of service did not suddenly lose their pension benefits. Although there are differences between health insurance and pension benefits, there is no reason why some type of vesting and accrual standards also cannot be applied to retiree health insurance benefits.

Furthermore, Congress should consider measures to facilitate the portability of retiree health insurance benefits. In recent years, there has been considerable discussion about the problems associated with the portability of pension benefits. The same concerns apply with respect to retiree health insurance benefits. Workers should not suffer a reduction in their retiree health insurance coverage simply because they change jobs. Some mechanism should be established to permit workers to carry their entitlement to retiree health insurance benefits from employer to employer.

The UAW also believes that Congress should consider measures which would encourage employers to maintain a defined benefit approach towards providing retiree health insurance benefits. Otherwise, employers will increasingly attempt to restructure their retiree health insurance programs towards a defined contribution approach in order to shift the risk of medical inflation to workers and retirees. In the end, this will only serve to undermine the scope of retiree health insurance coverage, thereby inhibiting access to needed medical services.

Much of the recent debate on the subject of employer-sponsored retiree health insurance plans has focused on the question of whether Congress should expand the tax incentives for pre-funding of the benefits. Some persons have proposed that the funding of retiree health insurance benefits should be treated like the funding of pension benefits—that is, employers should be given a tax deduction for contributions to a retiree health insurance program, and the earnings on the monies in a retiree health insurance program should be exempt from tax. This could be accomplished by creating entirely separate, tax-favored retiree health insurance funds, or by giving employers greater latitude to provide retiree health insurance benefits under their existing pension plans.

The UAW has a number of concerns about these proposals. First, even if Congress expanded the tax-incentives for pre-funding retiree health insurance benefits, this would still only be an attractive option for highly profitable companies with a strong cash-flow position. Employers experiencing financial difficulty probably could not afford to pre-fund their retiree health insurance benefits, but these are precisely the employers who are most likely to terminate or reduce their retiree health insurance programs. Thus, it is questionable whether expanding tax-favored pre-funding of retiree health insurance benefits will actually do very much to increase access to and the security of these benefits.

Second, if Congress decides to expand the tax incentives for pre-funding retiree health insurance benefits, the UAW strongly believes that this should be conditioned on the adoption of protections for employees and retirees. This must include minimum vesting and accrual standards, some mechanism to facilitate portability of benefits, and measures to encourage a defined benefit approach to providing retiree health insurance coverage. Under ERISA, the tax preferences for pre-funding pension benefits are expressly conditioned on the observance of accrual, vesting and other protections for plan participants. The same principle should be applied to tax favored pre-funding of retiree health insurance benefits. Employers should not be given a tax break unless employees and retirees are assured that they will actually receive meaningful benefits.

Third, the UAW is concerned about the potential revenue loss associated with expanding tax favored pre-funding of retiree health insurance benefits. Congress is already facing a difficult struggle over how to raise sufficient revenues to reduce the Federal budget deficit, and there are a host of pressing social needs which cry out for additional revenues.

However, we believe that the revenue loss associated with tax favored pre-funding of retiree health insurance benefits can be minimized, and perhaps even converted into a positive revenue item, by structuring the pre-funding so that employer contributions are paid to a program sponsored by the Federal Government, rather than into employer-sponsored trust funds. For example, employers could be permitted, on a voluntary basis, to buy into the Medicare program in order to provide health insurance coverage for pre-65 retirees, and to pre-fund these benefits by making contributions to Medicare during the working life of these retirees. Although there

would be some revenue loss if employers were given a tax deduction for any contributions to Medicare to pre-fund benefits under this program, this should be more than offset by the additional revenue which the Federal Government would take in as a result of the employer contributions. Requiring employers to pre-fund retiree health insurance benefits through a centralized program sponsored by the Federal Government would also help to facilitate the portability of retiree health insurance benefits, and would be consistent with a defined benefit approach towards providing these benefits.

Some persons have argued that the revenue loss associated with expanding tax favored pre-funding of retiree health insurance benefits can be avoided by simply allowing employers to transfer so-called "excess" pension assets to their retiree health insurance programs. This type of approach is also being touted as a "solution" to the problem of pension plan termination/reversions.

The UAW strongly opposes any proposals which would permit employers to transfer the assets in ongoing pension plans to their retiree health insurance programs. To being with, we question the assertions that this type of approach would avoid any revenue loss to the Federal Government. This approach is simply an indirect method of allowing employers to pre-fund retiree health insurance benefits through their pension plans. Even if the short term revenue impact were positive, in the longer run employers would likely increase their pension funding in anticipation of transferring pension assets to their retiree health insurance programs. Such increased pension funding would necessarily result in a substantial loss of revenue to the Federal Government.

More importantly, the UAW believes that the monies contributed to pension funds should be retained exclusively for use in connection with providing retirement income to the participants and beneficiaries. We should not allow employers to divert those assets for other purposes. Once this door is opened for retiree health insurance benefits, it will be impossible to prevent employers from expanding the list of "laudable" purposes for which the assets can be used. In the end, the retirement income security of workers and retirees will be undermined.

Some persons have suggested a possible "compromise" under which termination/reversions would be prohibited in exchange for allowing employers to transfer excess funds from on-going pension plans to their retiree health insurance programs. The UAW vehemently rejects this purported "compromise." We cannot support any proposal which fails to contain meaningful protections for workers and retirees covered under retiree health insurance programs, including minimum vesting and accrual standards, portability of benefits, and maintenance of a defined benefit approach towards providing the retiree health insurance benefits.

EMPLOYEE STOCK-OWNERSHIP PLAN (ESOPS)

The UAW is concerned about the increasing abuse of tax breaks for ESOPs. In recent years corporations have begun to use ESOPs as a mechanism to protect the position of incumbent management, rather than as a vehicle to foster employee-owned enterprises. These types of ESOP buyouts should more properly be called MESOPs—that is, management entrenchment stock ownership plans. ESOPs have also been used as a mechanism for financing corporate mergers and acquisitions of dubious social value.

The UAW strongly supports legislation to reduce the tax breaks provided to abusive ESOPs. This includes repeal of the 50 percent interest exclusion for financial institutions for interest paid on qualifying loans to ESOPs. There is no justification for providing tax preferences in situations where the ESOPs are structured in a manner which does not foster meaningful employee involvement in the company.

However, in the process of curbing tax preferences for abusive ESOP buyouts, it is important not to interfere with the legitimate use of ESOPs as a mechanism for encouraging employee owned enterprises. ESOPs have been used by employees, unions, and communities as a device to prevent plant closings and the resulting economic dislocation which is experienced by workers and communities. The UAW has actively participated in several situations in which companies were saved through worker buyouts. Our experience indicates that it is already difficult to raise the necessary capital to finance worker-owned ESOPs. Thus, any legislation should be careful not to increase the cost of raising capital for these types of ESOPs.

Accordingly, the UAW believes that any legislation which reduces tax preferences for abusive ESOPs should not apply to any situations in which:

- at least 30 percent of the equity in the corporation is owned by the ESOP;
- workers and their representatives have equal representation on the ESOP trust;

- voting rights are proportionate to ownership and are "passed through" to the employees at a rate no slower than the rate by which the loans used to acquire the securities are repaid; unallocated shares must be voted in the same proportion as allocated shares; and
- there is full disclosure of information, on a continuing basis, concerning the structure and finances of the ESOP and the employer, with particular emphasis on risks and prospects for the future.

ESOPs which meet the foregoing standards provide employees with a significant stake in their company. Since these types of ESOPs are consistent with the goal of encouraging meaningful employee involvement in enterprises, the tax preferences for such ESOPs should be maintained.

CONCLUSION

In conclusion, the UAW appreciates the opportunity to present its views on the subject of employer-sponsored retiree health insurance plans and employee stock ownership plans (ESOPs). These are complex subjects which will require careful consideration by this Committee and the entire Congress. We look forward to working with the Finance Committee on these important subjects. Thank you.

PARTIAL LIST OF CASES IN WHICH EMPLOYERS HAVE TERMINATED OR MODIFIED, OR ATTEMPTED TO TERMINATE OR MODIFY, HEALTH CARE BENEFITS FOR UAW-REPRESENTED RETIREES

LTV

White Farm Equipment

Lear Siegler Automotive Division

Massey Ferguson

Federal Mogul Corp.

Shatterproof Glass

Yard-Man, Inc.

Roblin Industries, Inc.

U.S. Broach

Acme Precision Products

Federal Forge

DeCoupes Industries

Wellman Dynamics

Facet Industries

Park-Ohio Industries

Strick Corp.

New Castle Foundry

Cleveland Manufacturing

Tecumseh Products

Keystone Consolidated Industries

Ingersoll Products

Desco Corp./Marshalltown Instruments

Johnson Bronze Co.

Allis-Chalmers Corp.

White Motor Corp.

Curtiss Wright

Century Brass

Evans Products d/b/a Racine Steel Castings

Huron Forge and Machine Co.

Cadillac Maleable Iron Co.

Norris Industries, Div. of Masco, Inc.

NL Industries, d/b/a Dohler Jarvis

Echlin

Emhart/Farrel

Kidde Belleville Div. of Walter Kidde & Co.

Lynch Corp.

Gougler Industries, Inc.

Northern Telecom

Acme Precision Inc.

Harris Graphics

Stanadyne Corp.

Toledo Pressed Steel

Wheelabrator Corp.

Suntech Industries, Inc.

Winpower, Inc.

Ryerson & Haynes, Inc.

THE UPJOHN COMPANY

7000 PORTAGE ROAD
KALAMAZOO MICHIGAN 49001-0199 U.S.A.

LAWRENCE C. HOFF
President and Chief
Operating Officer
TELEPHONE (616) 323-6127

July 19, 1989

The Honorable Robert Dole
Office of the Republican Leader
Room S230
Capitol Building
Washington, D.C. 20510

Dear Senator Dole:

The Upjohn Company is a research-based pharmaceutical manufacturer with more than 15,000 U.S. employees.

During the past few months, we have reviewed the formation of an Employee Stock Ownership Plan (ESOP) as part of our Matched Savings Program.

On June 19, 1989, the Company's Board of Directors approved the implementation of such a plan in the amount of $300,000,000. The approval of the ESOP was subsequently communicated to our employees, shareholders and the public.

As you know, H.R. 2572, which would eliminate the Section 133 tax incentives on ESOP loans, was introduced on June 7, 1989 in the House of Representatives by the Honorable Dan Rostenkowski, Chairman of the Ways and Means Committee. Similar legislation, S.1171 was introduced by you on June 13, 1989.

We were prepared to go ahead with implementation of an ESOP without the benefits of Section 133 since such a program would benefit our employees, enhance productivity, and allow greater direct participation in the future growth of the Company.

We are now well along in establishing the ESOP, and have spent considerable resources to complete the transaction.

However, on July 10, 1989 Chairman Rostenkowski added an amendment to H.R. 2572 which would eliminate the tax-deductibility of dividends paid into the ESOP available under Section 404(k). Also, on July 12, 1989, S.1303 was introduced in the Senate by the Honorable Lloyd Bentsen, Chairman of the Finance Committee which would restrict the availability of Section 133 benefits while retaining the benefits of Section 404(k).

We support the proposals introduced in the Senate by you and Senator Bentsen which we believe retain important incentives for companies to broaden employee ownership and participation in their future growth.

Sincerely,

Lawrence C. Hoff
President and
Chief Operating Officer

U.S. CHAMBER OF COMMERCE

Washington, DC, August 9, 1989.

Hon. DAVID PRYOR, *Chairman,*
Subcommittee on Private Retirement Plans and
Oversight of the Internal Revenue Service,
Committee on Finance,
U.S. Senate,
Washington, DC.

Dear Mr. Chairman: The U.S. Chamber of Commerce, the world's largest federation of businesses, chambers of commerce and trade and professional associations, supports Employee Stock Ownership Plans (ESOPs). ESOPs broaden the ownership of capital, give workers a direct stake in the future of their companies and in the success of the free enterprise system, foster participatory capitalism and encourage productivity by better harnessing the creativity and experience of workers.

The Chamber urges you to support retaining present law treatment of ESOP dividends. Section 404(k) of the Internal Revenue Code provides a deduction for dividends paid on employer securities held by an ESOP. The deduction applies when dividends are either passed through in cash to plan participants or used to pay ESOP debt.

Although S. 1171, introduced by Senator Dole; and S. 1303, introduced by Senator Bentsen, would not affect Section 404(k), the reconciliation bill that was reported by the Committee on Ways and Means would repeal the deduction for stock purchased by an ESOP after July 10, 1989, unless the ESOP owns at least 30 percent of the employer's stock.

Section 404(k) is an important incentive for companies to create and expand ESOPs. Erosion of the 404(k) deduction will discourage the formation of ESOPs and, thereby, curtail the most promising means of allowing employees to make capital investments that they would often otherwise be unable to afford.

Cash dividends from ESOP stock provide employees with current income or accelerate the transfer of stock to employees through more rapid payment of ESOP debt. In both cases, employees are the direct beneficiaries.

Elimination of the double taxation of dividends paid on ESOP stock encourages a full payout of the earnings on employees' capital and promotes a wider distribution of capital ownership.

Furthermore, Section 404(k) is the proper tax treatment of dividends. Presently, dividends are taxed twice, once as corporate profits and again as distributions to shareholders. The U.S. is currently the only Group of Seven country that provides no relief from the double taxation of dividends. This places the U.S. at a competitive disadvantage.

The double taxation of corporate dividends is one of several factors that make equity finance less attractive than debt finance. This issue was explored recently by both the Committee on Ways and Means and the Committee on Finance during hearings on leveraged buyouts. Many witnesses concluded that elimination of the double taxation of dividends would help to alleviate the present tax bias favoring debt finance.

The Section 404(k) deduction is an incentive for companies to share larger economic benefits with employees than is the case under other employee benefit plans. ESOP dividend payments are not subject to the Section 415 plan contribution limitations. This enables companies to provide a significant ESOP and also maintain other benefit plans.

The Employee Retirement Income Security Act's nondiscrimination rules apply to ESOPs. This ensures that ESOP dividends are distributed fairly to all participants.

Participants in ESOPs often receive convertible preferred stock. This generally provides greater security, a higher dividend and the highest voting power.

ESOPs gradually transfer capital ownership to middle-class workers. It is, therefore, puzzling that Congress would want to enact legislation that will discourage the formation of new ESOPs and the expansion of existing ESOPs.

The National Center for Employee Ownership reports that 10 million employees are covered by more than 10,000 ESOPs. ESOPs are becoming a widespread and popular form of employee ownership. For 15 years, Congress has passed legislation designed to encourage ESOPs. This is not the time for Congress to reverse course. Proposals to eliminate the deduction for dividends paid on ESOP stock appear driven simply by a desire for revenue rather than a sound policy rationale. Such proposals should be rejected.

The Chamber urges the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service to support retaining present law treatment of ESOP dividends and requests that this letter be included in the hearing record.

Sincerely,

ALBERT D. BOURLAND.

○

28-281 (176)